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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1870

E. I. DU PONT DE NEMOURS AND COMPANY, ET AL.,
Petitioners,

vs.

RICHARD J. COLLINS, JR., ET AL.,
Respondents.

No. 75-1872

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

vs.

RICHARD J. COLLINS, JR., ET AL.,
Respondents.

BRIEF OF RESPONDENT, LEWIS C. MURTAUGH, TRUSTEE FOR EMMANUEL AND HELEN STEIB, UNDER DECLARATION OF TRUST DATED 8/30/56.

LEWIS C. MURTAUGH,
TIMOTHY J. MURTAUGH III,
MURTAUGH, NELSON & SWEET,
105 West Adams Street,
Chicago, Illinois 60603,
Attorneys for Lewis C. Murtaugh, Trustee, as Above Described.

Gunthorp-Warren Printing Company, Chicago • Financial 6-6565

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OPINIONS BELOW AND JURISDICTION.

The opinions below and jurisdiction as stated in the DuPont-Christiana Petition (hereafter the D-C Petition) are accepted.

STATUTES INVOLVED.

The D-C Petition sets forth the most important parts of the Investment Company Act of 1940 but in Appendix A hereto this Respondent adds Section 1(a)(3) of the Act (15 U. S. C. §§ 80a-1(a)(3)) of the Act and Section 17(d) of the Act (15 U. S. C. §§ 80a-17(d).)

QUESTION PRESENTED.

The D-C question presented uses the word "reflect" twice—once to describe the Commission's decision to accept net asset value as controlling and the second time to describe the Court below's decision as requiring Christiana's market value to control. The SEC question presented uses "reflecting" only once, but clearly projects the same concept as the D-C Petition. Was the Commission right "in valuing the investment company *essentially* on the basis of the market value of its holdings which constituted substantially all of its assets, *rather than* on a basis reflecting substantially lower market value of its own outstanding stock." (Emphasis supplied).

No such issue is presented in this case. There is no dichotomy of net asset value or market value of Christiana shares. The Court's Opinion did not insist on giving Christiana's share of market value controlling significance but did insist on the necessity of taking Christiana's share market value as a factor into account as well as its net asset value (Pet. App. 54a, 56a, 57a, 58a, 61(a), 62a, 65a, 68a, 71a, 72a) (not to mention other factors). The question presented is therefore restated:

Was the Commission correct as a matter of law in holding that the Investment Company Act of 1940 requires that, in a merger of a controlling investment company into a controlled subsidiary, the exclusive inquiry by the Commission, as to the fairness of the merger ratio, should be whether the investment

company shareholders are receiving the net asset value of their shares.

STATEMENT OF THE CASE.

The Opinion below's statements of facts and of the case and the opinion itself is adopted with two reservations. See pages 41 and 60. To understand the Memorandum Opinion and Order Denying Rehearing and Leave to Adduce Additional Evidence (Pet. App. 40a), this Respondent's Supplemental Petition (A. A204-223) is important.

SUMMARY OF ARGUMENT.

DuPont is controlled by Christiana. Both the Majority and Dissenting Opinions agree that there was an absence of arm's length bargaining and that only limited weight could be given to the recommendations of the financial advisors (Pet. App. 97a, f. 7). The Commission's Opinion states that "the questions in our view are essentially legal" (Pet. App. 17a, f. 38).* It further states that its Opinion "rests on our reading of the Act, hence additional evidence cannot alter the result." (Pet. App. 42a). The footnote 6 following states:

> "Petitioner recognizes this. He says in his Petition: 'Reading the opinion of the Commission leaves the impression that there is no fact question that could move the Commission to abandon the legal rulings which seem to preclude and indeed preempt factual issues . . . there is little that can be done by way of evidence.' "

So, in the Commission's view, once it is settled that marketable securities are the assets of an investment company, that is the end of evidentiary detail. The ratio in a merger, even though the investment company controls both sides, *must* be based on net asset value as a matter of law. This Respondent's argument is that Christiana controlling DuPont, has a fiduciary duty in a

* The Commission did not purport to be exercising its discretion; it viewed itself as interpreting the law (Pet. App. 42a, footnote 5).

sale barred by Section 17(a), which has been construed to include a merger, to take into account the well-established norm that fiduciary self-dealing requires arm's length results. The exemption that is permitted from the absolute bar of Section 17(a) by reason of the provisions of Section 17(b)(1) is not only consistent with the fiduciary self-dealing standards, but is actually required by Section 17(b)(1). At the very least, it is not negatived by it. The legislative history of the Act, and the Commission's precedents support the view, carefully expressed by DuPont's own counsel, that net asset value is only one factor, not a single controlling factor (Pet. App. 53a, f. 12). The main thrust of the argument of this Brief, however, is that Section 17(b)(1) does not eliminate the necessity for finding the earmarks of arm's length bargaining in a fiduciary self-dealing involving a merger of a controlling investment company into a controlled affiliate.

If the foregoing argument is accepted, it should be superfluous to argue that there is positive detriment to DuPont shareholders (other than Christiana) because of the likelihood that the vast increase in the floating supply of DuPont which is made possible by this consensual transaction—thirteen and a half million shares (39%)—should be reflected in the ratio because of the market impact which will follow as a result of the now made possible sales of new DuPont shares. At best the Commission's treatment of this is in the nature of a demurrer. The Commission said it rejected market impact evidence "because we think such selling is irrelevant to the fairness issue." (Pet. App. 42a) and "because as a matter of law evidence on the probability of market impact would have swelled the record pointlessly" (Pet. App. 36a, f. 63). "Evidentiary details" were not involved in the Commission's holding (Pet. App. 42a).

Assuming the "earmarks of an arm's length bargaining result" concept are to be disregarded in this fiduciary-controlled consensual transaction, market impact considerations do require consideration. Commission studies show great concern about

market impact from the marketing of large blocks of stock. Evidence produced by DuPont and Christiana in earlier litigation involving the adverse effect of large sales of General Motors shares in the General Motors divestiture case (*U. S.* v. *DuPont* (1959), 177 F. Supp. 1) showed that a lesser tax free distribution percentage-wise of shares would have a ten-to-fifteen percent market effect lasting, until the distribution of General Motors shares was completed, from a program of selling .7% of General Motors shares a year over a period of ten years, postponable in bad years. In addition, there would be, here, detriments to DuPont as a company if the price of its shares were depressed in the event it had to raise new capital or wished to use its shares in an acquisition. The Court below recognized that it was error for the Commission not to take market impact into account, but, because of a misapprehension as to the size of secondaries that were provided for in the Registration Agreement, assessed the detriment as minimal.

Moreover, apart from the Act, the misstated economic realities and equivalencies, and the ignoring of other realities cannot be considered to result in a fair transaction. One of these realities is that tax factors are not the reason for Christiana's market price being so far below its net asset value.

There are a number of identifiable factors which support this Respondent's contention. The merger (like all other mergers, hopefully) does produce an incremental and synergistic effect which is truly spectacular, not only in terms of the half billion dollar increase in the market price of Christiana shareholders' holdings, but also in the equally valuable, but not so easily quantifiable, vastly increased marketability in the auction market, in block sales, and in secondary registration rights. In addition, of course, enabling Christiana to get all of these advantages tax-free requires DuPont's consent, which, in business relationships, is not gratuitously dispensed.

Much of the argument in support of alleged values is based on inexact terminology and specious reasoning. A product of

this type of reasoning is an untenable Commission conclusion (Pet. App. 32a):

> "An investment company, whose assets consist entirely or almost entirely of securities the prices of which are determined in active and continuous markets, can normally be presumed to be worth its net asset value."

That even the "fair market value of actively traded securities" cannot be assumed to be their market price in situations involving large holdings is strongly supported by a recent important study (see *Watts*, page 56, *infra*). The S. E. C. Petition ceaselessly tries to substitute the concept of a liquidation, which would not require consent, and both parties distort the Commission's Opinion to state that it "found" that that was involved was "an exchange of equivalents." The Commission made no such finding.

There was no error in the appointment of Dean Upson, it is submitted. The Court was entitled to guidance in economic matters, since the Commission refused to supply any, based on its interpretation of the controlling law. The Court could have gone to publicly available economic sources. It chose more fairly to seek help in this area in which it was inexperienced, gave notice of its intention, provided a copy of the report for comment, and then used it but slightly in its conclusions.

It is further argued that because of the striking disparity of the benefits which the Commission's Opinion details at great length, that there is no possible basis for sustaining the Opinion unless the Commission holding as a matter of law, that the Act mandates net asset value and requires Christiana to have a ratio which ignores its market value and also requires ignoring the vast incremental benefits, financial and otherwise, which will result from this transaction. However, even if the Commission is right in its interpretation of the law, so far as eliminating the need for arm's length bargaining and fair allocation of the benefits of the transaction, the question of market impact detriment should intervene to require a remandment to obtain evidence to define the probabilities in this respect.

The Court below went on in Section III of its Opinion to discuss reasons why the record as a whole does not support the Commission's general finding that the merger terms were reasonable and fair (Pet. App. 73), recognizing, in footnote 24 that "we might ignore the question on the theory that the Commission had not clearly focused on it because of its erroneous view of the law."

This Brief is very much extended by reason of the Court's decision to do this, but the evidence that is reviewed does demonstrate that although this merger cannot be sustained on evidentiary grounds, since the Commission based it on statutory grounds, a review of it can be based on the record as a whole.

A thumbnail one-page description of the benefits and detriments of the merger closes the argument (see page 70 *infra*).

Central to the argument, in many places, is the present and future holdings of Christiana shareholders. As the Court stated (Pet. App. 46a), 95.5% of all Christiana stock is held by 338 holders of 1,000 or more shares each. This indicates an average holding of around 35,000 shares. In the testimony of Mr. Shapiro, there is a further breakdown, that 132 of these holders hold over 5,000 shares each (A. A512). Assuming that the 206 shareholders who own less than 5,000 shares each held in fact 5,000 shares, that would still leave 132 holders of over 90% of the shares with an average holding in excess of 75,000 shares with a market price "value" of over $14 million dollars in new DuPont shares, a boost of about $4 million dollars apiece above the market price "value" of their Christiana shares prior to the merger announcement.

ARGUMENT.

I.

FIDUCIARY SELF-DEALING REQUIRES ARM'S LENGTH RESULTS.

Was there such arm's length bargaining or a resultant agreement which is equivalent thereto as is required by law in fiduciary or interlocking self-dealing matters? It is respectfully submitted that the answer to the stated question is in the negative. The SEC Petition seems inclined to agree, if this were a case involving unregulated companies. For the convenience of the Court, we assemble here some of the references and authorities dealing with the concept of an arm's length negotiation or bargaining or judging the results thereof by an arm's length bargaining standard.

In *Webster's Third International Dictionary (G. & C. Merriam Co. 1961)* "arm's length" is defined as:

> "The condition or fact that the parties to a transaction or negotiation are independent and one does not dominate the other. (sale at arm's length) (arm's length bargaining)."

In *Black's Law Dictionary* under the heading "at arm's length" it is stated:

> "Parties are said to deal at arm's length when each stands upon the strict letter of his rights and conducts the business in a formal manner, without trusting to the others fairness or integrity, and without being subject to the others control or overmastering influence."

In *International Radio Telegraph Co.* v. *Atlantic Communications Co.* (2 CCA, 1923), 290 F. 698, the Court said:

> "This brings us to consideration of the legality i.e. validity of the traffic agreement. The relation between a controlled and controlling corporation is sufficiently and instructively set out in Noyes on Intercorporate Relations (2d Ed)

> ¶ 300. The controlling corporation assumes a trust relation to the minority shareholders of the corporation controlled. That is, it is through the right of the minority shareholders of the controlled corporation that the equities of the rest of the world are worked out.
>
> The decisions relied on by plaintiff are fairly illustrated by Rubber Co. v. Goodyear, supra, and Bush v. Becker, 234 Fed. 79, 148 C.C.A. 95; where, in respect of accounting for profits derived from infringements, the courts refused to permit as proper expenses in diminution of profits exorbitant salaries paid to officials of the infringing defendants. Undoubtedly items of expenses may be looked into; the bald fact of payment by an infringing defendant under the title of expense is not enough.
>
> Thus to the legal rule stated by the learned master we give adherence, viz:
>
> 'A fair way to determine the question (of validity of traffic contract) is to consider whether the proposition submitted would have commended itself to an independent corporation. If to such a corporation the proposition would not have seemed unfair or unconscionable, a court should not be inclined to condemn the agreement merely because one party to it controlled the other.' "

In *Natural Gas Pipeline Co. of America* v. *Slattery* (1937), 302 U. S. 300, the Court said (at pages 307-8):

> "This Court has often recognized that the reasonableness of the price at which a public utility company buys the product which it sells is an appropriate subject of investigation when the resale rates are under consideration, and that any relationship between the buyer and seller which tends to prevent arm's length dealing may have an important bearing on the reasonableness of the selling price. (Citing cases) We have not said, nor do we perceive any ground for saying, that the Constitution requires such an inquiry to be limited to those cases where common control of the two corporations is secured through ownership of a majority of their voting stock. We are not unaware that, as the statute recognizes, there are other methods of control of a corporation than through such ownership. Common

management of corporations through officers or directors, or common ownership of a substantial amount, though less than a majority of their stock, gives such indication of unified control as to call for close scrutiny of a contract between them whenever the reasonableness of its term is the subject of inquiry. In these circumstances, appellant can hardly object to the attempted inquiry into the fairness of the price." (Citing cases)

In *Pepper* v. *Litton* (1939), 308 U. S. 295, the Court said (at pages 306-7, emphasis supplied):

"A director is a fiduciary. Twin-Lick Oil Company v. Marbury, 91 U.S. 587, 588. So is a dominant or controlling stockholder or group of stockholders. Southern Pacific Company v. Bogert, 250 U.S. 483, 492. Their powers are powers in trust. See Jackson v. Ludeling, 21 Wall. 616, 624. Their dealings with the corporation are subject to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. Geddes v. Anaconda Copper Mining Company, 254 U.S. 590, 599. *The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain.* If it does not, equity will set it aside."

Pepper v. *Litton* is one of the most frequently cited Supreme Court cases. There are 7½ columns of citations in Shepard's Citator for the years 1943 to 1961. It was cited, not long ago, on the point of the fiduciary obligation of a controlling shareholder to the corporation, its creditors and its shareholders. *Superintendent of Insurance of the State of New York* v. *Bankers Life & Casualty Co.* (1971), 404 U. S. 6, 12.

In *Schoenbaum* v. *Firstbrook* (en banc 2 CCA 1969), 405 F. 2d 215, 219, two mergers were involved. In one there were no conflicting interests among the merging companies and the Court refused to interfere because the terms were the result of

arm's length bargaining. In the other where a marked advantage accrued to the controlling interest, the Court sustained the challenge to the merger.

II.

IN A MERGER OF A CONTROLLING INVESTMENT COMPANY INTO A CONTROLLED AFFILIATE THE USUAL FIDUCIARY STANDARD THAT THE TRANSACTION BEAR THE EARMARKS OF AN ARM'S LENGTH BARGAINING RESULT IS APPLICABLE.

(a) *This is true, construing the statute itself.*

Both Petitioners' briefs seem to find it necessary to urge that the principles set forth in the preceding section of this brief are not applicable to transactions between a controlling investment company and a controlled affiliate but that the concept of honoring the net asset value as the *single* controlling consideration in fixing the merger is required as a matter of law. The Court's Opinion at pages 53a-58a strongly rebuts this position, and of course the advice the counsel for Du Pont gave each of the financial advisors set forth at Footnote 12 of the Court's Opinion (Pet. App. 53a) is contrary, especially the last sentence, *"No single factor has been considered determinative."* (Emphasis supplied). Mr. Shapiro, one of DuPont's negotiators, thought that it was critical to emphasize this statement in the cross-examination centered around the footnote (A. A 500). Evidently he little thought, nor did anyone else, including the Commission staff, that the Commission would find that the "single factor" of net asset value was an answer as a matter of law.

Commentators read the tenor of the opinions of the present majority of this Court in its interpretations of the scope of Section 10(b) of the Securities Exchange Act of 1934 (15 USC Section 78j(b)) as eliminating fairness as a consideration in suits under that Section unless there is manipulation, deception or fraud. The inclination is to construe congressional in-

tent strictly and to remit causes lacking these characteristics, for example, causes just based on fully-disclosed alleged abuse of control, or not involving a purchase or sale, literally construed, to state court remedies, without judging them fair or unfair. *Blue Chip Stamps* v. *Manor Drug Stores* (1975), 421 U. S. 723 at footnote 18. As the Court pointed out in *Ernst & Ernst* v. *Hochfelder* (1976), 96 S. Ct. 1375), it is true that Section 10(b) does not use the words "fair" or "fairness" but literally only mentions deception, manipulation or fraud, a narrower limitation than Rule 10b-5 17 C. F. R. 240.10b-5 could be construed to provide.

Contrariwise, Section 17(a) of the Investment Company Act of 1940 (15 USC §§ 80a-17(a)) prohibits sales or purchases (mergers are included in this category) between investment companies and affiliates, unless exempt under Section 17(b)(1) (15 USC §§ 80a-17(b)(1)) and is not the type of provision sometimes found in acts creating administrative agencies, which gives the agencies the right to establish rules which carry out the general purposes of the Act or carry out the public welfare stated in the preamble, thus enabling the agencies to define the meaning of the legislation in terms of the purposes of the Act as it interprets them. Section 17(b)(1) is carefully hedged about, consistent with the purposes of the Act as set forth in Section 1 (and as relevant to this cause, Section 1(a)(3) (15 U. S. C. § 80a-1(a)(3)) (see Appendix A page A1 *infra*). To grant an exemption under Section 17(b)(1) the Commission has a narrow path to tread. It has to find that

(a) evidence establishes that the terms of the proposed transaction

(b) "including the consideration to be paid and received" are

(c) "reasonable,"

(d) "fair," and

(e) "do not involve overreaching"

(f) "on the part of any person concerned."

The proposed transaction further "has to be consistent with the general purposes of this subchapter" (Section 17(b)(2) (15 USC §§ 80(a)-17(b)(2). One of these general purposes is the expressed concern in the opening Section of the Act about the use of investment companies "to dominate and control other companies." 15 USC §§ 80a-1(a)(3)), referred to in the Opinion below (Pet. App. 54a, p. 15) (see Appendix A, page A1, *infra*). The fairness issue, which is postulated by the 1940 Act (unlike Section 10(b) of the 1934 Act), cannot be avoided by the Commission by considering that a merger of an investment company into an affiliate permits the requirements of the Act, segregated above, to be *ipso facto* complied with, when the investment company is accorded net asset value in the merger. The 1940 Act was an Act drawn with great specificity and represented a compromise of ideas in which exact definitions and scope were spelled out (*Willheim* v. *Murchison*, 2 CCA 1965, 342 F. 2d 33, 42) *cert. den.* 382 U. S. 840. If it were intended to eliminate the historical requirements of an arm's-length bargaining result in a purchase or sale involving an investment company and its affiliate (or a merger included within this terminology), where one corporation controls both sides of a sale or merger, a clearer statement surely would have been included in this specific statute, or the matter left to rule-making.

In *Ernst & Ernst* v. *Hochfelder* (1976), 96 S. Ct. 1375, Justice Powell quoted from his concurring opinion in *Blue Chip Stamps* v. *Manor Drug Stores* (1975), 421 U. S. 730: "The starting point involving the construction of a statute is the language itself." In *Hochfelder*, Justice Powell went on to say at 1383, "The Commission would add a gloss to the operative language of the statute quite different from its commonly accepted meaning." A reference is made to *Addison* v. *Holly Hill Fruit Products* (1944), 322 U. S. 607. In that case the Court said at page 610 "The wider a delegation is made by Congress to an administrative agency the more incomplete is the statute

and ampler the scope for filling in, as it is called, the details." The Court went on to state at page 616:

> In the Fair Labor Standards Act, Congress legislated very differently in relation to the problem before us. To be sure the Fair Labor Standards Act was based on findings and a declaration of broad policy. But Congress did not prescribe or proscribe generally and then give broad discretion for administrative relief as in the Interstate Commerce Act or for remedies as in the National Labor Relations Act. Congress did otherwise. It dealt with exemptions in detail and with particularity . . . . A new national policy was here formulated with exceptions, catalogued with particularity and not left within the broad dispensing power of the Administrator. *Exemptions made in such detail preclude their enlargement by implication.* (Emphasis supplied.)

It will be noted that in Section 17(d) (15 USC §§ 80a-17d) of the 1940 Act, which prohibits an affiliated person of an investment company to "effect any transaction in which such registered company, or a company controlled by such registered company, is a joint or a joint and several participant with such person . . . *in contravention of such rules and regulations as the Commission shall prescribe* . . . (full quote in Appendix A, page A1 *infra*) *does* leave the Commission the right to prescribe standards in a semi-legislative way. This is in contrast to Section 17(b)(1) in which Congress prescribes the standards. (In this connection it might be parenthetically noted that the registration agreement which was worked out by Christiana and Du Pont would clearly seem to be a transaction such as described in Section 17(d) though never ruled on as such. The emphasis which is made at this point, however, is that the Commission is *not* given the right to set the standards for exemption on sales (which includes mergers). Congress has done that by specifying in detail when exemptions shall be granted in cases of sales (including mergers) under Section 17(b)(1) as contrasted with giving the Commission the right to provide by rule standards for other transactions under Section 17(d).

It is not necessary or appropriate to duplicate the excellent discussion of the Court below in interpreting the Investment Company Act of 1940. The Opinion thoroughly discusses other sections of the Act, relied upon by the Petitioners to buttress the Commission's net asset value interpretation as applied to Section 17(b)(1) (Pet. App. 55a-58a).

Speaking in the same spirit as *Wilheim* v. *Murchison*, 2 CCA 1965, 342 F. 2d 33, 42, against expanding the natural meaning of this very specific statute, this Court in *U. S.* v. *National Association of Securities Dealers (NASD)* (1975), 422 U. S. 694, 711-2, refused to *expand* a reference to "dealers" to include "broker-dealers." It rejected the "decision (below) *reflecting an expansive view* of Section 22(d)," (emphasis supplied) thus echoing the spirit of the *Wilheim* case. The *NASD* case, also, besides requiring a narrow construction of the 1940 Act, highlights, incidentally, the difference between open-end funds whose real net asset value is always available and closed-end funds in which the market find its own level of value, usually a substantial discount from net asset value.

In the *NASD* case, the majority of the Court eventually found that the rule-making power of Section 22(f) of the Act (15 USC §§ 80a-22f) gave to the Commission was exercised by Commission approved NASD rules and this provided an exemption from the antitrust laws. The NASD decision was 5 to 4. The dissent, granting the Commission had the power, queried whether it had ever used it. It is perfectly patent that if brokers banded together to assure that trading in the shares of a closed end investment company was stabilized at net asset value or any other figure, that the antitrust laws would be applicable and, of course, there is no statutory warrant for the Commission to grant protection with respect to the prices of closed-end fund shares after issuance. Curiously this is very similar to what the Commission has done here in attempting to assure that Christiana shareholders get the value of their restricted and illiquid shares in a highly negotiable and liquid stock which can be readily

converted into cash, or into cash less such market damage as may result if more is added to the supply side than the demand can absorb.

Overreaching

Moreover, the word "overreaching" has very similar connotations to the phrase "not bargaining at arm's-length" or not resulting in a transaction which has "the earmarks of an arm's length bargain," or reaching a result reflecting such a bargain or resulting in a "striking disparity" in benefits noted by the Commission's Opinion (Pet. App. 35a). An affirmative resolution of the inherent conflicts can be reached when the bargain which results is one which an independent, willing buyer who does not have to buy and an independent, willing seller who does not have to sell would agree to, bargaining as hard as possible, but consistent with their attitude or willingness to consider bargaining for whatever advantages there are to be gained from the transaction and especially for a share of the increment.

The Petitioner's briefs overlook the fact that there can be no overreaching of Christiana, which involves the assumption that Christiana is being forced into this merger. This is not true. If there is any force, Du Pont is the only one being forced. There might be some unfairness if Du Pont were able to force Christiana to dispose of its shares, or of its assets, by merger or otherwise at the market value of Christiana shares, or even at any discount from net asset value. There simply cannot be any "extracting" as reasonably interpreting what the Act is driving at. Extracting implies an ability to enforce one's will in a transaction which lacks "the earmarks of an arm's-length bargain". Only Christiana can do this.* The Act cannot contemplate that a controlled corporation can overreach its con-

* *See Harvard Law Review, Case Comment,* 90 Harvard Law Review (Dec. 1976) 453-459-60 as to the *dominant* party being the one Section 17(b)(1) was intended to give protection against.

trollers who can both propose and withdraw a proposal and, better still, coerce acceptance* unless the law intervenes so that withdrawal is not needed.

Consideration paid and received

The Commission's Order of Exemption (Pet. App. 36a) omits (fatally, it is submitted) and Petitioners conveniently overlook an important part of Section 17(b), (A. 26) which reads as follows:

> . . . The Commisison shall grant such application for an order exempting a proposed transaction from one or more provisions of said subsection and issue such order of exemption if evidence establishes that—
>
> (1) The terms of the proposed transaction, *including the consideration to be paid or received,* are reasonable and fair and do not involve overreaching on the part of any person concerned; . . . . (Emphasis supplied)

It is not surprising that the emphasized matter is consistently omitted by those seeking to sustain the Opinion, and indeed by the Commission's Opinion itself, because it focuses on what is paid and what is received, and tends to suggest that a consideration of balance *is* required for fairness. As far as Christiana shareholders are conecerned, they are exchanging their shares worth $147 for DuPont shares worth $189. DuPont, in taking over Christiana's assets, is getting something the market valued at $147 and giving something the market valued at $189. The Opinion says that the benefits need not be "nicely balanced" but, as this Respondent's brief in Section VIII shows, the merger terms are patently not balanced at all and are unfair on their

* In *Kern County Land Company* v. *Occidental Petroleum Corp.* (1973), 411 U. S. 457 the court said (at page 594), "In deciding whether borderline transactions are within reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent . . . thereby endeavoring to implement Congressional objectives without extending the reach of the statute beyond its intended limits."

face. Section 17(a) literally prohibits sales and purchases. Can anyone doubt that the "consideration" factor isn't the foremost badge of a fair deal in this type of transaction? Since mergers are sales under Section 17(a), the italicized sentence should be given full value here, and a "striking disparity" (Pet. App. 35a) or "incommensurate" (Pet. App. 18a) share is not consistent with the statutory mandate with respect to consideration. The Commission is entering an Order which failed to include a finding as to "the consideration to be paid and received" was defective and not in compliance with the requirements of Section 17(b)(1) of the 1940 Act.

(b) *Legislative history supports the continued vitality of requiring an arm's-length bargaining result, a vitality in no way impaired by Chenery II.*

The next approach in this matter is to consider whether the legislative history of the statute and its forebears justify an interpretation such as is claimed by the Petitioners and in substance reflected in the Commission's Opinion. It is submitted that there is no justification, not only in the language of Section 17 of the 1940 Act, but also in the legislative history to justify the conclusion that Congress intended first to ban purchases and sales (including mergers) in Section 17a and then to permit them by Section 17(b)(1) on the simple finding that the controlling investment company had a right to impose its will on a controlled affiliate in a non-arm's length bargaining situation regardless of striking disparities in the distribution of the increment from the merger and incommensurate benefits to the affiliate and its shareholders. (See Section VIII of this brief for a thumbnail description of the benefits of the merger and of its detriments.)

The earmarks of an arm's length bargaining transaction are really defined in Section 17(b)(1) of the 1940 Act, but the concept of arms length bargaining is embodied, *in haec verba,* in the 1935 Act, which was a progenitor.

Section 1a of the Public Utility Holding company Act of 1935 (15 U. S. C. § 79a) is captioned "Necessity for Control of Holding Companies". After reciting various administrative and legislative reports indicating the need for legislation, it catalogues the then present situation, which called for legislation. Among the elements detailed is the following (emphasis supplied):

> "(2) when subsidiary public-utility companies are subjected to execessive charges for services, construction work, equipment, and materials, *or enter into transactions in which evils results from an absence of arm's-length bargaining. . . .*"

In the definition Section of the 1935 Act, § 2(a)(11)(D), 15 U. S. C. § 79b(a)(11)(D), the word "affiliate" of a specified company is defined, among other descriptions, as (Emphasis Supplied):

> "(D) any person or class of persons that the Commission determines, after appropriate notice and opportunity for hearing, to stand in such relation to such specified company that *there is liable to be such an absence of arm's-length bargaining in transactions between them* as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person be subject to the obligations, duties, and liabilities imposed in this chapter upon affiliates of a company."

In Morgan Stanley & Co. v. *The Securities and Exchange Commission* (2 CCA 1942), 126 F. 2d 325, at 332, Judge Learned Hand dealt with the language of the statute last above quoted as applied to a Commission rule which denied compensation to an underwriter which qualified as an affiliate of a utility holding company under the 1935 Act. The court majority upheld the regulation on the ground that the Commission had the right to discourage underwriting transactions with affiliated underwriters on the theory that "the utility company in its bargaining with the banker may be actuated in part by motives *other than driving the hardest bargain it can. . . .* Again I

construe 'arm's-length bargaining' as going *beyond* conventional fiduciary relationships; indeed this seems to me obvious, else the definition would have been redundant. . . . It is notoriously difficult to ascertain just what motives prompt an act—the actor is often the worst witness* and it is legitimate to avoid such a treacherous issue even at the expense of condemning transactions blameless if the whole truth could be known. Indeed the whole law of fiduciaries is built upon just the difficulty of learning the truth with the crude means available." (Emphasis Supplied) Both Mr. Shapiro and Mr. McCoy, the negotiators for Du Pont, considered themselves as representing all of Du Pont's shareholders, including Christiana (A. A475, A605, 6) and both from the start had no intention that Du Pont should share any part of the increment created by the merger and accepted as a principle from the start that the market price of Christiana should be disregarded as a factor (A. A478, A579). Such discount as might be obtained was solely for the purpose of getting proxy statements from people who might visualize (or recognize) the situation as one involving no advantage for Du Pont (A. A476). The Commission's opinion recognizes that there was no arm's-length bargaining (Pet. App. 35a f.62) and, in effect, says that it might well be that a different result would have obtained if there were (Pet. App. 24a). The dissenting opinion of Judge Stephenson (Pet. App. 97a, F.7) agrees with the majority and the Commission that "'substantial weight cannot be given to the bargain reached because of the absence of arm's-length bargaining . . . further that only limited weight can be given the recommendations of the financial advisers . . . I do not disagree neither does the Commission."

* Each of the DuPont's negotiators were "an actor who often is the worst witness" per Judge Learned Hand's statement. In pursuit of their goal to free DuPont's management from control by transferring control to DuPont's management (themselves), (A. A472-5, 6) with half a billion dollar bonus to Christiana shareholders plus an equal additional advantages in marketability and in tax freeness and the detriment of market depression from probable, or only possible, selling of additional shares from the 39% added to the floating supply of Du Pont.

Much reference has been made to decisions under the 1935 Act, especially Chenery II. Essentially this decision was governed by the same principles as *Morgan Stanley & Co.* v. *The Securities and Exchange Commission, supra,* except that the result, eliminating a non-harming fiduciary profiting, is obtained by a Commission decision rather than a Commission rule. The D-C Petition at page 12, distorts the *Chenery II* case (*Securities and Exchange Commission* v. *Chenery Corp.* (1947), 332 U. S. 194 and the *Chenery* case quotation by insertion of bracketed material "the Commission's conclusion here [*as to the fairness of a reorganization under the Public Utility Holding Company Act*] rests squarely in that area . . ." (Emphasis supplied). The Chenery case dealt with the soundness of a determination that a reorganization manager as a fiduciary should not be allowed to keep a profit which he made by purchasing securities in the open market, *at no harm to the company under reorganization,* but at a figure below the value of those securities as determined after the reorganization. The reorganization terms were not in question nor was the fairness of the reorganization in question nor was there any occasion to substitute the Commission's judgment of a transaction which was or was not the product of arm's length bargaining nor to examine the transaction to determine whether there were earmarks of arm's length bargaining.* Furthermore, Chenery II is an example of ***heightened*** fiduciary responsibility, not *lowered* as the Commission's opinion does here, using the 1940 Act to justify engorgement of the fiduciaries in a consensual setting by a half million dollars

* In Justice Jackson's vigorous dissent, Justice Frankfurter joining (two other justices abstained and one concurred in the result 332 U. S. p. 209) the following statement appears (at page 211):

> "It is helpful, before considering whether this order is authorized by law, to reflect on what it is and what it is not. It is not conceivably a discharge of the Commission's duty to determine whether a proposed plan of reorganization woud be "fair and equitable."

Despite Justice Jackson's attempt to be helpful the bracketed material is designed to give Chenery II a misinterpretation.

in the market price of their securities. Chenery II found that these heightened responsibilities resulted from the 1935 Act which lifted the responsibility above the general law of fiduciary responsibility. In Chenery I, *Securities and Exchange Commission* v. *Chenery Corporation* (1943), 317 U. S. 80, Justice Frankfurter said at p. 89 "Congress certainly did not mean to preclude the formalization by the Commission of standards expressing a *more sensitive* regard for what is right and what is wrong than those prevalent at the time the Public Utility Holding Company Act of 1935 became law." Chenery I simply decided the Commission had misapplied prior fiduciary law and refused to support the Commission's Opinion on that basis.

Chenery II drew its strength from the generalized concepts and insights not dealt with specifically in the statute and so decided to be within the scope of Commission determination. Here we have a very specific statute in Section 17(b)(1) (see page 12, *supra*) and there is no occasion to decide it on the basis of selected preamble concepts or other sections of the Act as more fully argued in Point (a), *supra*, of this section of this Brief.

The closing paragraph of the 1935 Act (15 U. S. C. § 79z-4) indicates that Congress had become convinced that all was not well in other fields where companies used other companies to their advantage. The concluding sentence of the paragraph is:

> "The Commission is hereby authorized and directed to make a study of the functions and activities of investment trusts and investment companies, the corporate structures, and investment policies of such trusts and companies, *the influence exerted by such trusts and companies upon companies in which they are interested*, and the influence exerted by interests affiliated with the management of such trusts and companies upon their investment policies, and to report the results of its study and its recommendations to the Congress on or before January 4, 1937." (Emphasis supplied.)

The strongest possible "influence exerted" by an investment company "upon companies in which they are interested" is a mandated sale to, or merger with, a controlled company which does not bear the earmarks of an arm's length bargain.

The Court's Opinion dealing with legislative history of the 1940 Act (Pet. App. 58a) preordained in the 1935 Act, is excellent in its quotation from the *"SEC, Report on the Study of Investment Trusts and Investment Companies; Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies, H. R. Doc. 279, 76th Cong., 1st Sess. (1939-1940) at 1411,"* and especially in the italicized portion showing the Act to come was designed to force transactions that were to be exempted into the mold of transactions which "bear the earmarks of an arm's-length bargain" (Pet. App. 59a). The excellent presentation contained in the Opinion, could not be improved upon.

(c) *The Commission precedents do not justify ignoring, as a matter of law, all factors except net asset value.*

No basis in the Commission's precedents nor in the principles stated therein, support the interpretation that, as a matter of law, fairness in merger of an investment company into an affiliate, which the Investment Company controls, must be on the basis of the net asset value of the Investment Company. The Commission's opinion does effectively turn its back on an arm's-length bargaining result (Pet. App. 35a, f.62), and, in effect, concedes that there are no "earmarks" of such in this situation (*e.g.* "striking disparity" Pet. App. 35a). It remains to be developed in this section as to whether there are precedents developed by the Commission which are entitled to be respected as long time interpretations by an agency given an important role in connection with such transactions.

The Court's Opinion specifically points out (Pet. App. 59a) that the absence of arm's-length bargaining for the best possible bargain was the undesirable situation the 1940 Act was designed

to mitigate, and the Court went about it by looking at the results to compare them with arm's-length bargaining results, in other words, to determine "whether or not under all the circumstances the transaction carries the earmarks of an arm's-length bargain" citing (at Pet. App. 61a) *Pepper* v. *Litton* (1939), 308 U. S. 295, 306-7).

The Commission's quotation from *Atlas Corporation*, 1956, 37 S. E. C. 72, 85-86 (Pet. App. 35a, f.62), recognizes that under some circumstances arm's-length bargaining may not be possible in view of the relationship of the parties. Immediately following the quotation in the Commission's footnote, the Opinion in *Atlas* states, "We need not resolve the question of whether or not the Albuquerque exchange ratio was determined at arm's-length *because we must consider independently the fairness of the merger proposal*" (Emphasis supplied). There were comparisons of net asset value, *market value, factoring in of tax factors of various sorts, increased marketability by providing "a much broader and active market"* (Emphasis supplied), and an increased dividend. The Commission, in other words, searched for and found the "earmarks of an arm's-length bargain." It did not turn its back on seeking arm's-length bargaining results as in this merger. *Atlas Corporation* is not cited in either opposing briefs, *and little wonder.* Involved in *Atlas Corporation* was a merger of four operating companies and one investment company, all affiliates, into Atlas, an investment company which had substantial holdings in each of the five companies to be merged. Net asset value was always a factor but never found controlling in the Commission's reasoning, but market value, asset value, increased marketability and numerous other factors were taken into account. The Commission stated, (Emphasis supplied) ". . . *market prices are an important factor to be considered in approving the fairness of transactions under the standards of Section 17 of the Act* . . ." (p. 88). While each ratio had its variables, the Court found that the result would be a net asset value reduction for Atlas of "not more than 4%"

(p. 91). (So much for the D-C petition's claim (p. 7 Footnote 3) that the "discount in favor of Du Pont stockholders was somewhat higher than any discount previously approved by the Commission (1.5%)".*

In *International Mining Corporation* (1956), 37 SEC 209, cited in the Court's Opinion (Pet. App. 62a), to show that many elements were factored into the Commission's Opinions the Commission stated, "If the relative market prices were the sole criterion, it would appear that the merger exchange ratio is disadvantageous to the stockholders of International". The Commission, by this statement merely denied that market price was the *exclusive* determinant (which is the misleading implication at several places in both Petitioners' Briefs as to this Respondent's contentions and the Court below's holding). The Commission, in *International Mining*, went on to say, ". . . while market prices are *an important factor* to be considered in appraising the fairness of a transaction under the standards of Section 17 of the Act, they cannot be regarded as controlling" (Emphasis supplied). Market value of Christiana is given no place, let alone an important place, in the Commission's treatment here, neither are increased marketability, tax considerations, lack of benefit and, in fact, actual detriment from market depression of Du Pont stock, which the Commission considered not "cog-

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* In *Fair Shares in Corporate Mergers and Takeovers, Brudney and Chirelstein*, of the faculties of Harvard and Yale (1974), *88 Harvard Law Review*, 297, 310, in dealing with the sharing of merger increment in footnote 36, the authors state, presumably not carelessly:

> "The sharing requirement is sometimes found in opinions of the Securities and Exchange Commission dealing with the fairness of mergers under the Investment Company Act, 15 U. S. C. § 80A (1970). LaSalle St. Capital Corp., SEC Investment Company Act Release No. 6693 (Aug. 23, 1971); Talley Indus. Inc., SEC Investment Company Act Release No. 5953 (1969-1970 Transfer Binder), CCH Fed. Sec. L. Rep. § 77,774 (Jan. 9, 1970); Townsend Corp. of America, SEC Investment Company Act Release No. 4045, at 35-39 (Sept. 2, 1964); Atlas Corp., SEC Investment Company Act Release No. 2920 (Oct. 19, 1959). *Compare* Burco Inc., 15 S. E. C. 828, 832-33 (1944), *with* Iowa Interest Corp., 40 S. E. C. 927 (1960)."

nizable" (Pet. App. 22a) as a matter of law (Pet. App. 42a).

Before turning to an examination of the three precedents relied upon by the Commission we refer again to the advice of Du Pont's counsel to the financial advisors at the time of their retention which is set forth in Footnote 12 of the opinion (Pet. App. 53a). Surely this outstanding firm knew whereof it spoke when it gave the advice as to what the Commission examines in Section 17(b)(1) cases which is exactly contradicted by the Commission's opinion.

The Commission cited three decisions to support its statement (Pet. App. 32a, footnote 57); ". . . we have viewed net asset value as the controlling factor in Section 17 proceedings". The first of these citations is *Harbor Plywood Corp.* (1962), 40 SEC 1002, 1010. This case came to the Commission at the end of a substantial derivative suit controversy in which it was charged that the operating company, which held over 70% of the shares of the investment company, had manipulated affairs and abused its fiduciary position. However, by the time it went to the Commission for exemption, there had been *an arm's length agreement* of settlement by the contestants, and the Opinion mentions the agreement of the parties on net asset value, plus added benefits, hardly a controverted decision by the Commission. A notice of the hearing was circulated to Harbor Plywood shareholders and some appeared and participated in the hearing. While the earlier litigation might be considered to be rather hard-fought, the opposition at the hearing was not very impressive. In a case where it is charged that a majority holder had done things to hurt the price of the investment company shares, it is not surprising that part of the settlement would be at least conceding net asset value as a basis for a settling merger and, in fact, the Investment Company shareholders received more than their net asset value in settlement of their claims for damage. There is just no gainsaying that there was no principle involved that in mergers there must be an exchange ratio based on the investment company's net asset value; that is, until this matter under review.

The second citation is *Delaware Realty and Investment Company* (1961), 40 SEC 469, 473. This case is discussed in the Court below's Opinion (Pet. App. 63a) as based on available alternatives. DuPont's counsel in its memorandum "Factors to be Considered in Report of Investment Bankers" (A. A848) dated June 6, 1972 the same date as the formal retention of the investment advisers (A. A846) stated as follows (A. A849-50):

> "From du Pont's point of view, the most favorable terms of a merger would be those that approach the full amount of the discount. However, in the Delaware Realty case, the SEC accepted, as a basis for merger terms, values based on underlying net asset values. *The rationale for this was that the parties to the merger had alternative means of recognizing net asset value without significant tax effect.*[1] [1. Other similar cases considered by the SEC have involved little or no discount, *but have not expressed a specific rationale* for this approach.] We understand that Christiana would be prepared to take the same position here: Under the 30-day liquidation provisions of Section 333 of the Internal Revenue Code, Christiana presumably could achieve with relatively limited taxation a liquidation in which its du Pont securities would be distributed directly to its shareholders. Counsel to Christiana is preparing a memorandum describing the application of Section 333 to a dissolution of Christiana.
>
> The report *should* indicate whether, *on the assumption that the 30-day liquidation provisions would operate to Christiana's benefit here, du Pont would be justified in giving little weight to the market value of Christiana in the merger negotiations.*" (Emphasis supplied.)*

The engrossing case of *Central States Electric Corporation* (1949), 30 SEC 680 was a bankruptcy reorganization in which the plan approved, among competing plans, for the elimination

* This is an egregious example of what in the Court's Opinion and in the opinion of the SEC staff substantially undermined the asserted independence of the financial advisers (Pet. App. 76a and Footnote 28 thereto). The text at this point concentrates however on the solidity of the Commission's statement that net asset value was controlling in view of its cited precedents.

of two investment company subsidiary affiliates of the debtor, itself an investment company, with their portfolio assets becoming assets of the debtor, and the debtor becoming an open end investment company, which makes net asset value the sole valuation factor under Section 22 of the 1940 Act. The opinion has some language, general in nature, but dicta in the context of this case, which is verbally close to the language used by the Commission in this case. The extraordinary leverage in the debtor made it essential for the Commission, in line with its allegiance to priorities in debtor re-organizations (as well, of course, as considering priorities as its principal concern in public utility company reorganizations) to deny to lower classifications of debt and equities the advantages which they would obtain, if they could limit the higher classifications to the market price of the disappearing investment companies, and not to the portfolio prices of the disparate marketable securities which the debtor would receive. Since the goal of the reorganization plan was to reconstitute the debtor as an open end investment company, the value of its assets resulting from its subsidiary investment companies disappearance would have to be at their market prices (there is nothing consensual about the situation). The Commission's general language is hedged; viz: "under the circumstances of this case" (page 700) "by and large" (page 700). The fact that a key factor of the plan to exchange one of the subsidiary's portfolio stocks for its own stock outstanding could be accomplished without tax consequence was also crucial (page 691-2). This situation was no longer available under later tax reform amendments (A. A295).

As far as uncontested ruling go, in *Securities and Exchange Commission* v. *Sterling Precision Corp.*, 2 CCA (1968) 393 F. 2d 214 cited by the Court (Pet. App. 63a), the opinion states:

> "The SEC is right in saying we should decide the issue as one of federal law, even though a Delaware court construing its corporation laws might come to a different conclusion. *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U. S. 65; *Tcherepnin* v. *Knight*, 389 U. S. 332. . . .
>
> There remains only the contention that for over twenty years the Commission has considered § 17(a)(2) to cover redemptions, even when these were total, see In the Matter of Atlas Corporation, 23 S. E. C. 43 (1946), or pursuant to a sinking fund requirement, see In the Matter of Bankers Securities Corporation, 25 S. E. C. 325 (1947), unless the redemptions were within the exemption established by Rule 17a-4 in 1947. In both these cases the applicants voluntarily sought exemption under § 17(b), the applicability of § 17(a) being simply assumed, and the exemption issued. *Uncontested administrative construction of this nature carries relatively little weight. Fishgold* v. *Sullivan Drydock & Repair Corp.*, 328 U. S. 275, 290; *Skidmore* v. *Swift & Co.*, 323 U. S. 134, 140; Cf. *Volkswagenwerk Aktiengesellschaft* v. *FMC*, 390 U. S. 261." (Emphasis supplied.)

(d) *The Commission's opinion disregards DuPont's and DuPont's shareholders' legitimate interests in an arm's length bargaining result, including sharing in the incremental values of the merger, in this fiduciary context.*

The Opinion of the Commission breaks new ground in eliminating the consideration of arm's length bargaining, or an arm's length bargaining result, where there is common control of two corporations. It, in effect holds that it is not necessary that resultant merger terms be that which would, or even might, be arrived at by independent corporations free to merge or not to merge. No amount of scrutiny, let alone "rigorous scrutiny" (*Pepper* v. *Litton*, 308 U. S. 295, 307), is called for or recognition that both sides to a transaction are free to walk away in an arm's length transaction is in order. Even a demonstration that DuPont's shareholders would definitely suffer a loss in the market value of their shares, and that DuPont itself would suffer because of the depreciation of the value of its shares, if it uses them, as it has frequently done, to make acquisitions, and further

in the event it would find it helpful to go into the capital market to issue new shares.

The Opinion gives a good deal of attention to the market impact argument.* Essentially, however, it considers that market impact is immaterial even if demonstrable. This is the only inference that can be drawn from the Opinion and especially from the denial of Petitioner's Motion for Rehearing and for Leave to Adduce Additional Evidence. (See page 3 of Release No. 8692, and footnote 6 thereto) (A. A80). Thus even if it was demonstrated that there could be market effect, great or small, short or enduring, that Wilmington Trust Company would choose for a variety of reasons, including diversification, but not exclusively for that reason, to reduce its gargantuan billion dollar holdings of marketable DuPont by two-thirds, and if many of the affiliated and unaffiliated holders should choose to sell to take advantage of the $42.00 rise in price, a result called for by the laws of supply and demand, and if even the Directors of Christiana should feel the same urge, presumably changing their stance, so that there would be concededly market damage, nevertheless Christiana would not be *permitted* to merge at much greater discount than the 2½% or to put it another way, at a lesser premium than 28.5% over the previous market value of Christiana shares. Thus it would seem that the Commission as a matter of law interprets the Investment Company Act of 1940 as making immaterial independent negotiations, or a result which would be consistent with arms-length.

Logically, if the 1940 Act is so pervasive, and the net asset value of Investment Companies so sacrosanct, the Commission should not permit any discount and the record is clear that the concept that DuPont should be allowed to share in the benefits was in fact rejected and the discount *was* a mere pacifier

* See DuPont and Christiana's presentation on market impact in *United States* v. *DuPont* (1959 N. D. Ill.), 177 F. Supp. 1 rather fully treated in the next section of this brief.

(Opinion, page 11) (Pet. App. 13a). No one viewed the discount as a sharing (A476, 581).

It is hard to see what Christiana has to offer here that would justify its claiming all of the merger benefits. The Commission's Opinion concedes this and makes its decision on the supposition that there is truly no other benefit to DuPont than the 1.8% discount from Christiana's net asset value which will result, based on the figures prior to the merger talk, in DuPont's earnings being increased three cents a share out of around $7.33 in 1971. It is conceded on all sides that this would not result in any market improvement or change the opinion of an analyst, speculator or long or near term investor. In a sense, giving the concession as a benefit really amounts to a deceptive device. If the DuPont shareholders were represented by independent negotiators, it is perfectly obvious that they would have sought at least some of the benefit, perhaps ½ (equality is equity) that their cooperation made possible. In any event, they should have some proportion.* A company income increase of three cents a share out of $7.33 is an insult, not a benefit.

In an independent association, there is no need for either party to merge unless it chooses to do so. Probably the best things for DuPont and its shareholders is not to merge, but DuPont under common control did not have this choice. Furthermore the active management of DuPont would not have obtained control from the vendors of it here if they did not go along and quite reasonably might fear they would fall vulnerably out of favor. This transaction, as the Opinion notes, is a zero for DuPont and its shareholders. When Christiana had the votes to force a merger, the negotiators had only the question of the terms before them. It turns out now by virtue of the law made by the Commission's decision there was a very narrow range of bargaining

* This sentence, copied from this Respondent's Eighth Circuit Court Petition for Review was printed long before the *Harvard Law Review Case Comment* (page 54, *infra*) suggested an even split of the benefits (*90 Harvard Law Review 453 at 460*).

room available, and that DuPont's cooperation deserves no financial recognition in the wealth it generates. It does, after all, contribute its price to generate the wealth and this should be taken into account, as well as the fact that, theoretically it loses nothing in the view of the Applicants and the Commission, a view not shared by your Petitioner.

Per contra, the fairness of DuPont's sharing in the incremental values from a merger with a controlling fiduciary, in which it and its shareholders' participation is an essential element, has recently been strongly supported in principle. See the lead article in the December, 1974 issue of the Harvard Law Review by Professors Victor Brudney of Harvard and Marvin A. Chirelstein of Yale. *"Fair Shares in Corporate Mergers and Takeovers,"* 88 Harvard Law Review 297. Though the authors illustrate their point with an example of a fiduciary controller absorbing an affiliate and producing incremental benefits, their thesis is that on fiduciary principles the increment should not be absorbed by the power center.

III.

MARKET IMPACT IS OF GREAT RELEVANCE AND IMPORTANCE IN THIS MATTER, ALTHOUGH PROBABLY A SUPERFLUITY.*

(a) *Commission studies.*

We refer the court to a *Study of Mutual Funds, Wharton School of Finance and Commerce,* contained in the *Report of the Committee on Interstate and Foreign Commerce, H. R. Report No. 2274, 87th Cong., 2nd Sess., 1962.*

The above is a Report to the Securities & Exchange Commission which, in turn, forwarded it to Congress. Thereafter it was printed as a House Report. There are two sections of the Study which have a special significance to the DuPont-Christiana merger and the market impact which may be expected when Christiana Securities Company, a closed-end investment company, is merged and its shareholders become DuPont shareholders. The 132 shareholders hold over 90% of the new DuPont shares in average blocks in excess of 75,000 shares (A. A512 and see page 7 *supra*), and if they move out of their DuPont shares in any quantity, will each cause market impact similar to the market impact that might be expected, and which is studied, in connection with portfolio liquidations of investment companies. It certainly is much more relevant to

* The "superfluity" assumes that the arguments of the preceding sections of this Brief (and any points made hereafter other than related to market impact) are not sufficient to dispose of this matter. The Commission's Opinion designated market detriment as "the crux of the case." Obviously there was a great deal of cutting and fitting in the preparation of the long-delayed Opinion, 21 months after hearing and 17 months after oral argument. This resulted apparently in transferring the "crux" to the "striking disparity" of benefits. This Respondent primarily relies on this striking disparity, but subsidiarily urges that if this is not controlling, then market impact is a supervening circumstance that is relevant and pertinent, and that evidence with respect to it is not pointlessly swelling the record, as the Opinion states (Pet. App. 36a, footnote 63), nor is it irrelevant (Pet. App. 42a).

relate to market impact studies in this connection than in relation to ordinary stock transfers in small round lots (see footnote page 56 *infra*).

Chapter VI, at p. 359 *et seq.*, deals with *"Impact of Investment Funds on the Stock Market."* At p. 363 the Report points out, *"a continuous succession of short run stimuli could affect the level of stock prices for a long period of time or at least until the stimuli was withdrawn."* (Emphasis supplied.) The discussion, of course, refers to the stimulation, upward or downward, from substantial institutional type purchases or sales. This is strikingly similar to the testimony in the General Motors divestiture case to be discussed later in this section.

The Commission's opinion seems at a loss in simply confronting an extremely simple problem whether some factor should be allowed for market impact from the vast increase in the floating supply, and the probable increase on the supply side of the supply-demand equation in the market which will inevitably (probably? possibly?) depress prices over a period of time. Its treatment (Pet. App. 26a-31a) is rather wide-eyed as if it had expertise enough to see the extent of the problem but absolutely no ability to judge whether experience or analysis might lead to a reasonable conclusion that it would be fair to make some allowance in the ratio for market impact.

The term "market impact" is featured in the wide variety of Commission documents incorporated in House Reports. In the Report, *"Public Policy Implications of Investment Company Growth,"* prepared by the Securities & Exchange Commission and forwarded to Congress, *H. R. Report No. 2337, 89th Cong., 2nd Sess., 1966,* Chapter VII (pp. 275-306), deals with the subject of investment company growth *and market impact*. Secondary distributions are described at p. 282. In a subdivision entitled "Mutual fund impact on stock market prices," there is a statement that the assessment is complicated by the numerous factors affecting the market at any time, p. 286.

This last circumstance did not prevent the Commission from plunging ahead to some generalizations or conclusions. Contrastingly, in the Commission's opinion here (Pet. App. 31a and footnote 55 thereon) agnostically protests that stock prices are volatile and the factors that influence them multifarious as if this is an excuse to ignore market impact, not as controlling but simply as a factor.

(b) *The General Motors Divestiture litigation evidence.*

The Commission has had market impact under its microscope so many times that it must know its importance in dealings in large blocks. This Respondent however presented the evidence in the General Motors divestiture case *United States* v. *DuPont* (N. D. Ill. 1959), 177 F. Supp. 1), the only comparable case in the law books.

Dr. Irwin Friend of the "Securities Research Unit" of the Wharton School of Finance and Industry was one of the authors of the *Study of Mutual Funds* (*supra*, p. 33) and signed the transmittal letter on behalf of the Unit. Obviously, Dr. Friend is a man of some prestige and information. Part of his testimony in the General Motors divestiture case is found in the Appendix of this case (A. A895). His testimony was that *the effect of a large secondary might last as long as fifteen months* (A. A891, 2). In view of the provision for an annual registration rights for secondary offerings at the request of Christiana holders and without reference to DuPont's control, plus the twice-a-year registrations in April and October for sales in the auction market or by block selling or any other method of distribution other than an underwritten secondary (A. A961-5), it was, to say the least, callous indifference on the part of persons having charge of the welfare of DuPont shareholders to disregard this factor.

There is also testimony of DuPont witnesses in the divestiture suit, part of Murtaugh's Exhibit 2 in this case. A partner in Morgan Stanley and Company (A. A903-7) and an officer of

Merrill Lynch, Pierce, Fenner & Smith (A. A911-2) both testified to a ten- to fifteen percent effect of repetitive sales *even if pending tax revisions, designed to make the General Motors divestiture tax-free, were adopted.*

In the lower court hearing in the General Motors divestiture case, *U. S.* v. *DuPont*, 177 F. Supp. 1, 31, the opinion of Judge LaBuy expressly recognized the testimony of Witness Lenz of Merrill Lynch, Pierce, Fenner & Smith in connection with the elimination of any tax element from the merger:

> "Lenz also gave his opinion as to the effect of the Government plan in case a bill such as S. 200 passed and the du Pont Company made one distribution of the 63,000,000 shares of General Motors, but where the trustee still sold shares going to Christiana and Delaware in ten equal annual installments. He estimated a 10% to 15% decrease in market price."

See also the excerpt from DuPont's Supreme Court Brief (Appendix B, pages A2-3, *infra*), reviewing the evidence on market impact with the heaviest emphasis on the effect of repeated sales. *United States* v. *DuPont et al.* (1961), 366 U. S. 316.*

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* Despite the Supreme Court's refusal to support any solution to the Clayton Act violation other than divestiture, Congress was so impressed with the DuPont and Christiana contentions as to market-depressing tax selling if the General Motors share were treated as a taxable dividend which were strongly pushed before its committee (Murtaugh Exhibit 1 not printed) that it passed special tax relief legislation. The legislation is found in 26 U. S. C. 1111 and 301(f). Even after the tax relief bill, however, the District Court Judge on the final remand to implement the divestiture directive of the Supreme Court found that periods of *34 months* for DuPont shareholders and *36 months* for Christiana shareholders were each "the shortest period within which such divestiture can be executed with due regard to the circumstances of this particular case" (Murtaugh Exhibit 9, A. A951, 2, 6). The circumstances, of course, were that 22% of the General Motors stock previously held by DuPont were to be added to the floating supply. Here 28% of DuPont is proposed to be added to the floating supply and in *one* distribution.

(c) *Consequences of impact.*

Let us consider the situation if, for a period of years until the market can absorb the price depression resulting from the three-pronged entry into the market of new DuPont shares,* there would be an average depression of 10%, which would not have occurred if the 34 million of DuPont in the floating supply had not been increased by the thirteen and a half million shares held by Christiana. This price depression, of course, would affect the new DuPont shareholders if they sold, by reducing their $42.00 per share theoretical increment which is based on the $189.00 market price of 1.23 shares of DuPont. Approximately $19.00 would be eliminated from the increment, leaving a net available increase of $23.00 instead of $42.00, or approximately 15% as opposed to the 29% that they would gain were there no market impact. The corollary, however, is that all other DuPont shareholders would be affected by the 10% price decrease. Excluding the new DuPont shares, the 10% decrease from a price of $168.00 per share would be $16.80 per share, or a total of around 571 million dollars in price depression (34 million multiplied by $16.80). On this basis it would appear that the market price of Christiana shares, already 25% below its net asset value per share, would just about equal the market impact. This suggests that the merger ratio should be based on Christiana's market price rather than its net asset value, since the entire difference is absorbed by the market depression factor, assuming a 10% market depression over a period of time.* In the Table (Pet. App. 104a-108a) attached to the Court's

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* (1) Sales of unregistered shares in the auction market not limited as to 25% of the new DuPont shares and permissible up to 50,000 to 60,000 shares apiece in six months as to restricted shares (A. A429), (2) sales of registered shares in the auction market or in block selling (A. A439), (3) sales by registered secondaries once a year if over 25 million dollars is involved (A. A430-31). The Registration Agreement itself is found at (A. A961-5. Murtaugh Exhibit 15.)

* Neither Respondent suggests more than half.

Opinion there are valuable comparisons based on different ratios. The columns (h) and (i) are especially instructive. Column (h) gives approximately half the increment of each of the merging parties but keeps Christiana's distributable dividend income intact, being enabled to do this because of the elimination of the inter-corporate income tax, but still affording Christiana shareholders a 272 million dollar increase in market price with the benefit of feasible marketability and tax freeness in addition. Column (i) assumes that the entire increment is eliminated; that is, that the exchange is at Christiana's market price.

(d) *Detriment to DuPont as a company.*

It is not correct to say that DuPont itself would suffer no detriment from a depression in the market price of its shares. Two detriments are apparent.

At the DuPont divestiture hearing DuPont introduced evidence by Dean Neil Jacoby of the U. C. L. A. Graduate School of Business (A. A909-910) as to the harmful effect on General Motors if the price of the General Motors stock would be depressed by a factor of 20% and if General Motors should attempt to raise capital by a new stock issue, which, of course, would produce less cash and thus raise its cost of capital.*

The second detriment is that DuPont would suffer from a depression in the price of DuPont stock in that it might interfere with the use of its stock in acquisitions, or might require it to issue more shares than it otherwise would. See the article "Shenandoah Oil Ends Merger Talks with DuPont," *Wall Street Journal*, July 12, 1976, p. 6. See also *Business Week* item in July 29, 1976 issue, p. 54. The lowered price of DuPont apparently aborted this acquisition by stock when Shenandoah sought a larger number of shares than previously agreed to; this is a lost

* Murtaugh Exhibit 2 is much longer than the material shown in the Appendix (A. A891-912) and can be quickly read, but the entire exhibit is, of course, only a fraction of the several thousand pages in the transcript of the divestiture hearing.

opportunity affecting DuPont, and derivatively all DuPont shareholders, including long-term investors. Companies with adequate information and good judgment are liable to be wary of a stock being acquired which has a large block selling or secondary overhang situation and certainly will want to renegotiate if the shares they expect to get drop in price.

It is not correct, therefore, to say DuPont itself would not be hurt by market depression of its shares.

(e) *"Long-term investors" concepts or verbiage add nothing here.*

The Opinion of the Commission seems to ultimately rest on these sentences: "The record indicates that most of Christiana's stock is held by long-term investors. Hence there is no pressing need to depart from the net asset value test (Pet. App. 32a). In the accompanying footnote 37 the Opinion states "Investment companies are as a general rule media for long-term investment. This makes net asset value the touchstone."

At the SEC hearing, Charles Townsend of Morgan Stanley & Company stated that large stockholders of Christiana might not have been able to sell their Christiana shares if they wanted to, even though the share price, due to the announced merger terms, had gone up to within 4% of the 1.123% discount from the net asset value agreed upon by the Boards, because large stockholders (insiders) would not have been able to sell in the auction market, since such sales would have been subject to registration under the Securities Act of 1933 (15 USC Sec. 77a) (A. A280). This point was missed in the expertise analysis of the writer of the Commission Opinion, who drew an inference that long-term holders of Christiana had, by reason of their long-termness, justified the conclusion that they would hold on to their new DuPont shares (Pet. App. 32a). The marketability of the new DuPont shares is enlarged upon elsewhere in this Brief. The effect is to substantially eliminate the reason why Christiana shareholders had held on to their shares. Greater marketability

(the chains of Rule 144, 17, CFR § 230.144 loosened 30 to 1 over its Christiana restriction) was one of the factors the president of Christiana indicated as a reason for the merger (Pet. App. 48a, fn. 5).

Moreover, by definition their long-term holding would be ended by the merger and new conditions will apply of higher prices, greater marketability, less yield per dollar invested than presently, and, best of all, registration rights on call at their own direction and discretion.

Wilmington Trust Company, with its 56% of new DuPont shares in a liquid market would be no longer able to defend itself on the grounds that its holdings were so huge and restrictions so confining, that it was useless to attempt to sell, as it was in the Christiana market.*

The golden chains that held large Christiana shareholders in their shares will have been cut, with gold added in the process, and it is idle to think under these conditions that there will not be substantial liquidation and consequent market impact. The Commission wisely made no finding as to how the stock would fare under these conditions, and it refused to receive evidence on the subject (Pet. App. 40-43a) reasonably requested by your Respondent in his Supplemental Petition as irrelevant (A. A204).

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* On trust diversification imperatives, see "Market Funds and Trust Investment Law," Langbein and Posner, Volume 1976, No. 1, American Bar Foundation Research Journal, page 1, at pages 3-21. See also Kripke, *A Search for a Meaningful Disclosure Policy, 31 The Business Lawyer* (A. B. A. 1976) 293 at 305-6. Section III of Professor Kripke's study entitled "Some Aspects of the Economics of the Securities Market" (at pages 305-12) may be especially helpful to the Court. On the opening page of the article itself (page 293), the author states:

> "When one reads the economic literature, one realizes almost at once that there is a hiatus between the SEC's pretensions as to what it is accomplishing and the economists' appraisal of what the SEC is accomplishing. The economists almost totally ignore the SEC, treating it like some imperfection in a communication system, like some static. Its role is obviously not of fundamental importance to their thinking."

(f) *Misapprehension of the Court below.*

The D-C Petition objects to the Court's finding (Pet. App. 92a) that market impact was a factor that should have been taken into account. However, it is obviously gratified that in summing up, the Court below referred to this detriment it had found as minimal (Pet. App. 91a). The Court's assessment of minimal detriment is based on a substantial misapprehension as to how great and continuous underwritten offerings could be.

Bolstering the foundation of the Court's Opinion finding of error in the Commission's failing to give any weight to the factor of detriment to DuPont shareholders (Pet. App. 90a) is the fact that Court Opinion erroneously assumes that "the merger agreement, however, provides that once a year an underwitten offering of $25,000,000 in the then current market value of such shares can be made. At the average price of $165.00 in the first 6 months of 1972 this would approximate 153,000 shares" (Pet. App. 90a, f. 38). The Court Opinion's error in regard to secondaries is twofold; the first, and least important, is that the merger agreement is not the instrument which refers to underwritten offerings that reference is found in the agreement regarding registration (A. A962-964) which was considered after the agreement to merge in principle had been made in July of 1972. Disclosure of its terms in general was made by the introduction into evidence of the then current draft of the registration agreement by this Respondent as Murtaugh Exhibit 15 (A598). The second, and more significant, error in the Court's Opinion (Pet. App. 90a, f. 38), but one which only fortifies its conclusion of materiality is that the reference to the underwritten offerings of $25,000,000 once a year is not correctly stated be the floor but incorrectly stated to be the ceiling for such underwritten offerings. In other words, the registration agreement provision is that the underwritten offering shall not be less than $25,000,000 (A. A963), but it can be as much more as the former Christiana shareholders

choose to demand. In fact, DuPont is required to notify other shareholders having registration rights so they may add on (A. A963-4). Were it not for the error the court might well have refrained from classifying the potential detriment as minimal. The Court failed to study Dean Upson's Report which referred (A. A1001) to much larger secondaries which had been referred to in the record of this case (DuPont Exhibit 2 not printed). Referring to secondaries of 90.5 million dollars and 239.8 million dollars which would equal 1.16 and 3.06 of DuPont's outstanding shares (A. A1002) the Upson Report pointed out that

> "Of the above-listed numbers of shares, those arising out of the secondary offering are larger, as a percentage of outstanding shares, than those referred to in the testimony from the *General Motors* relief proceedings included in the Joint Appendix. That testimony is summarized in Mr. Murtaugh's Brief, p. 63, '. . . the market impact on General Motors would be 15% from a program of selling 0.7% of General Motors for ten years (postponable in bad years).'"

A further point supportive of the Court Opinion is the fact that DuPont has no power to refuse to register its shares for underwritten secondary offerings annually (A. A963-4) unless it would interfere with its current financing (A. A964-5). The reason secondary offerings can sometimes be effected with surprisingly short term adverse market effects is that the company can exercise its best judgment as to when, in its interest and the interest of its shareholders, the adverse effects will be offset by other factors (A. A269-70). With the discretion solely in the hands of individual Christiana shareholders as to where their bests interests lie, the potential for damage is greatly increased and the remaining shareholders of DuPont are hostages to fortune.*

* On direct examination Charles Townsend of Morgan Stanley testified on the basis of an assumption of 10% of DuPont Company stock, 4.7 million shares, being marketed over a period of five years. As to the time span of periodic market effects following

(Continued on next page)

Of course, the size of the issue and its market impact, which might be well called minimal if limited to 153,000 shares, as the Court assumed, cannot be so judged when it may be limitless, beyond DuPont's control, and must be above 153,000 shares. There is no limit, except in the disparate selling shareholders discretion to prevent overtaxing the market, which Du Pont's Morgan Stanley witness warned against (A. A270-1).

IV.

THE COMMISSION'S OPINION ASSERTS ECONOMIC REALITIES AND EQUIVALENCES WHICH ARE NOT REAL, IGNORES OTHER REALITIES, AND ERRONEOUSLY ARRIVES AT AND SANCTIONS A DIVISION OF INCREASED VALUES WHICH IS NOT FAIR.

Things equal to the same thing are equal to each other. Yet no one would claim that ownership of a share of DuPont was essentially equal to the ownership of .87 share of Christiana. To state the reverse, a share of Christiana is essentially 1.15 shares of DuPont, is simply to use loose language suitable perhaps for limited purposes. When a loose generalization with some utility and limited truth is frozen into a universal affirmative proposition, it is not surprising that an unreal conclusion is reached logically from the swollen major premise. This sophistical reasoning deserves study.

(Continued from preceding page)

successive issues, he testified (A. A270-71) "It would be difficult to tell. Maybe a month, maybe two months, maybe even three months, *depending on the market conditions at the time,* the way in which the underwriting has been done. We would not want to recommend that sellers of duPont stock *overtax the market at any particular time,* and *the size of the issue would have to be gauged accordingly*" (Emphasis supplied). Neither Morgan Stanley nor DuPont have any controlling thing to say about the *size* of an issue, or whether it would overtax the market at any particular time under the Registration Agreement (A. A962-5). Therefore, the assumptions in the witness' testimony as to detrimental market effects based on postulated good market conditions or a limited size of the issue and a gauging based on any DuPont Company interest as against the seller's view of their own best interest is fanciful.

There are, of course, obvious differences between ownership of a share of DuPont and the ownership of a share of Christiana. A Christiana shareholder does not own DuPont, it is owned by Christiana. If he converted his Christiana shares to cash, before the merger talk he would get only ⅞ of the price of a share of DuPont stock. It would take 8 shares of Christiana, in even barter at market prices, to acquire 7 shares of DuPont. (The merger gives him 9 shares of DuPont for 8 shares of Christiana.) In a liquidation he would, of course, get his 9 shares of DuPont but at a tax cost totaling possibly a billion dollars to individual shareholders. The three million shares of new DuPont which would have a zero basis would involve a taxable gain of well over a half billion dollars figured at the time the ratio was struck in July, 1972. It is only by the cooperation of DuPont that the Christiana shareholder is put into a position to avoid the immediate tax burden.

As a holder of Christiana, shares he cannot vote in DuPont elections, except derivatively as part of a block. He cannot sell an aliquot part of Christiana's DuPont shares as he, post merger, could sell DuPont shares. He does not share in the undistributed earnings and profits of DuPont. The 2.2 billion dollar figure he sees in the footnote to Christiana's financial statements as net asset value he knows means little, partly because Christiana's large taxes if it sold DuPont would wipe out at least ¼ and partly because the sum is simply not realizable for blocks of that magnitude as Christiana's reports and filings constantly warn. In fact instead of using the word value or market value Christiana's tables constantly say, "Shares owned times price per share" except in the merger documents where it is so documented only in the accountant's footnotes (A. A494-5). *In fact, the 2.2 billion dollar figure is a figure based on a floating supply which excludes Christiana's DuPont shares.* Lastly, he knows if Christiana liquidates he would have to sell 25% or more of the shares he gets to pay for capital gain taxes if he has a zero basis and, of course, somewhat less if his basis is above zero. Still, speaking

loosely, but closer to the point, what a Christiana shareholder has is not DuPont stock but an aliquot share in a huge block of DuPont stock with many impediments and barnacles on it to distinguish it from other DuPont shares.

Nevertheless, there is a seeming but deceptive fairness in a merger in which existing DuPont shareholders simply retain their present shares. The argument is that they suffer no change and, therefore, should neither complain about the merger nor seek an exchange ratio for Christiana shares, or Christiana's DuPont shares, which will, in effect, divide among all DuPont shareholders at least part of the vast increase in values of the investors in Christiana which its cooperation makes possible. The reason appearances are deceiving so far as existing shareholders are concerned is that the existing DuPont shareholders hold their shares in a context where there are only 34 million DuPont shares in the floating supply. When as a result of the merger 13½ million shares of DuPont owned by Christiana are added to the floating supply, the existing DuPont shareholder while firmly clutching the same certificate has been forced to consent to a radical change in the floating supply situation and in the relation of his shares to the total floating supply. The financial advisors all recognized this. Edward Townsend said that the ratio should be adjusted in favor of existing DuPont shareholders, if there were going to be substantial sales (A. A367-8) and that he had extensively discussed this possibility (A. A345-6) and had been reassured that there would be no such sales. Amusingly, Chairman McCoy described the extensive discussion as being one in which Mr. Townsend reassured him there would be no impact (A. A585). The report of Kidder, Peabody Co. was specifically based on the assumption that there would not be substantial sales (A. A839). Morgan Stanley's report relied exclusively on the tax basis deterrent so far as its written report was concerned (A. A625). On cross-examination Charles Townsend of Morgan Stanley agreed that if there were to be substantial sales that should have been taken into account (A. A292).

The plain evidence of the lack of arm's-length negotiation is the simple faith (?) with which the DuPont side accepted verbalization gleaned from assurance by the attorneys representing Christiana that there were no present intentions to sell (A. A584-5). It might be conceded, for the purpose of argument, that if Christiana shareholders agreed not to market their shares, except for special needs such as to pay death taxes or changes of conditions not presently foreseeable, and, if such an agreement was implemented in some reasonable way so as to secure its performance, that DuPont shareholders might have, at least, some basis for confidence that there had not been too great an alteration in their previous status as the holders of shares which had only 34 million shares in the floating supply. It is not fair and reasonable, however, to expect DuPont shareholders not to suffer some adverse consequences from the increase of nearly 40% in the floating supply simply on the verbalization floating around when the ratio was struck on July 6, 1972. DuPont shareholders will *not* have the same shares post-merger as they had before and there is every reason, in view of this, in equity and fairness that the tremendous advantages which come to Christiana shareholders should be more fairly distributed among all DuPont shareholders. There surely would be no extortion or exaction in this situation, only some type of sharing. After all, to extort or exact from Christiana would require it or its shareholders to be held in place, while they are free to refuse to merge.

The DuPont negotiators from the very start had no intention of claiming a share of the benefits (A. A579-580) being content to get control, a matter of, at best, indifference, and not at best, of possible damage to DuPont shareholders as the Commission Opinion recognizes (Pet. App. 19a-20a), but were interested in getting independent financial advisory support for this non-sharing in benefits and stooped to conquer by stressing the alleged Section 333 alternative which justified both ignoring the market value of Christiana, and the impact on DuPont shares of the

increase in the floating supply, and the sales from the newly acquired DuPont at a mark up of over 28% of the market price Christiana investors had prior to the merger. It should be stressed that the alleged liquidation alternative further included not only ignoring Christiana's market price but also argued that market impact would be immaterial because the increase in the floating supply of DuPont would be the same if there was a liquidation as it would as if there was a merger. The implications of removing the alternative never had a chance to be considered because the negotiation was over before the advisors were told that the liquidation alternative was not feasible. There never was an interval, therefore, in which market impact could have been given the serious studied decision both as to whether there should be a merger, or what the terms should be, reflecting the fact that the merger itself was the only way Christiana could get the vast benefits.

Reasonably independent negotiators guided by an interest in the DuPont shareholders other than Christiana could certainly say, "Those we represent should be entitled to share in the greater "benefits" which are being created. Whatever post-merger impacts occur are solely within former Christiana holders control, be they short or long term impacts. It is realized that you will share them from a platform which a merger creates which raised the value of your investment at least 30% by simple arithmetic and so you have a cushion other DuPont shareholders do not. The marketability you obtain will be in the form of added supply. It is fair that we ask a share of the benefits (which, of course, you will recapture to the extent of 28%)." Here is a point at which true negotiations at arm's-length would reasonably, rationally, morally and ethically factor in the market value of Christiana shares and the increase in the floating supply as an element to be considered not ignored.

Looked at in another way, The Commission in its wisdom and sophistication indicates that the situation as between DuPont and Christiana was such that there may not have been

the possibility of arms-length bargaining (Pet. App. 35a f. 62). The Commission had great difficulty with this case because of the great disparity of the benefits but pejoratively suggests on page 18 that anything much better accomplished by bargaining of unrelated parties would have been "exacted" (a "handsome price" might have been "exacted") (Pet. App. 24a). This is unfair argumentation, tending to stigmatize a person who only wants a fair share, as an extortionist, twisting the matter around as Christiana's shareholders gets more marketable shares, shares which if prudently handled might be considered to be the equivalent of cash, or, at least, cash less market impact they create, involved in the increase of the floating supply or their own sales. A figure some where less than a 30% increase in its investment values, say 20%, would certainly not be extortion or exaction. Christiana, at present, receives taxable dividends on 1.15 shares of DuPont for each Christiana share outstanding, and after deducting its cost of administration .3% and Federal dividend taxes 7.2% it distributes to its shareholders approximately 107%.

While it might be argued that the market price of an operating company stock reflects a direct evaluation of a variety of operating factors, it can also be said that all of these operating factors of portfolio companies plus a congenital market discount with respect to closed-end funds is just as must an evaluation of the investment company. With respect to evaluation of an investment company's shares, certainly, in any other merger with a manufacturing company, other than DuPont, the valuation of Christiana shares, for example, would be taken into account, and the fact that DuPont is not even to be allowed to take into account the actual value of Christiana shares is solely a function of Christiana's control of DuPont and its ability to generate in DuPont's negotiators a will to rule out any factoring in of Christiana's market value. The discount at which the closed-end funds sold with reference to asset value is set forth in the Appendix to the Opinion (Pet. App. 102a).

In the face of these figures, for the Commission to say that the value of a closed-end investment company is the market price of its portfolio shares (Pet. App. 32a) is beyond comprehension. It is purely fiction, but the fiction is made real life in this case because Christiana is the dominant party in this situation and has the power to turn fiction into real life.

To deviate from these facts-of-life considerations and to impose a rigid rule that net asset value has to be the basis of a merger involving shares of a closed-end investment company is to go beyond reasonableness in interpreting a statute which requires all of the factors stated in Section 17(b)(1) to be taken into account. The Opinion does not make a narrow interpretation of the facts in this particular case based on the 98% holding of DuPont. It is general in character and principled on net asset value. It is not based on facts at all, and it finds no redeeming feature so far as DuPont is concerned other than the increase in DuPont's shareholders' net income per share by about 4¢ out of $7.33. It even implies that this is a harsh result since it states that anything greater would be harsher (Pet. App. 23a).

Tax Factors Are Not the Reason for Christiana's Market Price Being So Far Below Net Asset Value.

Both petitions isolate and identify tax factors as "the primary reason" Christiana shares have sold at such a large discount from net asset value (SEC Brief, p. 7; D-C, p. 6). Subsidiarily, the Briefs respectively mention "a relatively limited" and "a comparatively thin" market.

An obvious tax factor is the Federal inter-corporate tax on dividends which reduces the amount of the dividends received by Christiana which Christiana cannot distribute to its shareholders by 7.2%. Attributing any part of the discount to this circumstance is difficult to justify. Christiana shares were selling at over $20 less than a DuPont share, though Christiana held 1.15 of DuPont for each of its outstanding shares. If anything, Christiana should have been selling on an income basis about

7% above the price of DuPont. The Commission's Opinion recognizes this (Pet. App. 12, 23a, f. 44). A person, in other words, could purchase 7% more income on a share of Christiana than he would get from purchasing DuPont for a $20 greater investment. The percent yield per market price was much more favorable on Christiana.

The second tax related reason stated is Christiana's extremely low, relatively negligible, tax basis in the DuPont shares it holds. This is not an acceptable reason, because if Christiana were to sell its shares, it would wipe out approximately 30% of its net asset value, not to mention the collapse of the market for the rest of its shares because of market impact. The Opinion recognizes this fully in stating that this tax circumstance would inhibit any sale of DuPont shares by Christiana (Pet. App. 14a). So it couldn't be that this highly unlikely possibility had the slightest bearing on Christiana's market price. Furthermore, in Applicants' Exhibit B (A. A633), the Kidder Peabody Report states that, "As contrasted with the ordinary diversified investment company which also customarily sells at a discount, the consideration of possible taxes on gains or losses arising from sales of securities would appear to be of less significance in the case of Christiana since it has not engaged in sales of portfolio holdings."

The fact of the matter, as the Commission's Opinion notes, is that "Christiana, like most closed-end investment company issues, has long tended to sell at a discount from net asset or liquidation value" (Pet. App. 5a). The Court Opinion (Pet. App. 86a and 87a), in recognizing the factor of the intercorporate dividend tax and unrealized capital gain tax as merely "affecting", not explaining, the market price of Christiana's merely, stated that this was not a reason to ignore Christiana's market value. In Footnote 36 (Pet. App. 87a), the Court affirms the Commission's statement, above quoted, as to the endemic nature of the closed-end discount from the net asset value of closed-end funds' portfolios. It cites, among other authorities,

"*Discounts and Premiums on Closed-End Mutual Funds; a Study in Valuation*" by Kenneth J. Boudreaux (May, 1973, 28 Journal of Finance 515-522). That author states categorically, "the market price of a closed-end fund can fairly confidently be considered to represent the best estimate of the funds true value at each point in time" (p. 521). A thorough reading of the Boudreaux article does not disclose that the author assigns the reason for *any* part of the closed-end funds market discounts from net asset values to tax considerations.

In a recent issue of "Business Week" (June 28, 1976), at page 86, there is an article about a proposal to establish regular payouts from closed-end mutual funds, invading principal if necessary, in an attempt to encourage investors who at present rely on just the income of the funds. There was some difference of opinion in the mutual fund industry as to such a proposal. The article says:

> "But the doubters are watching closely to see whether the prospect of large, regular distributions will reduce the large discounts from net asset value at which almost all closed-end funds usually sell.
>
> Nobody really knows why these funds do sell at such substantial discounts. For example, the $640 million Tri-Continental Corp. and $470 million Lehman Corp., the two largest, are both trading at the moment on the New York Stock Exchange at around 26% below net asset value.* The Assn. of Closed-End Investment Companies has funded a study at the Wharton School of the University of Pennsylvania to discover the reasons, but advance reports suggest it may be inconclusive."

The testimony of Charles Townsend of Morgan Stanley to the same effect is set forth in the Court's Opinion (Pet. App. 57a, f. 14). Edward Townsend of the First Corporation was even more emphatic (A. A366) that the net asset value of Christiana shares was no index of its value, but that Christiana's price was its value. Later he reiterated that Christiana share-

* This is not a "thin" or "limited" market.

holders were not holding DuPont shares underpriced and that Christiana shares were not underpriced (A. A369). Even Mr. Shapiro testified to the same effect (A. A495).

This Respondent agrees with the *Harvard Law Review Case Comment* (page 54, *infra*), that sharing the tax benefit is justifiable since it cannot be accomplished without DuPont's cooperation, and, absent Christiana's control, that it would obviously be shared, probably equally. The argument for a sharing in the benefits of this "consensual" transaction however, has another facet. In fact, it implies in one sense that Christiana shareholders, while reaching for the near half billion dollar benefit for the exclusive enjoyment of its shareholders, will fall short to the extent that the market is depressed by the increase of nearly 40% in the floating supply of DuPont shares above the 34,000,000 of DuPont shares now floating. Christiana shareholders will be richly rewarded in principal and income increment, and tax benefits in any event despite market impact but there will be no compensating features to the detriment suffered by the other DuPont shareholders. Christiana shareholders will get the theoretical increment of close to a half billion dollars minus the market detriment from the increase in the floating supply brought to market. DuPont shareholders who sell will get their pre-merger price minus the currently effective market detriment. Allowing for this is not sharing at all. It is only an adjustment to preserve the status of DuPont shareholders relative to the floating supply before the merger, the barest requirement of justice and fairness, when DuPont and its shareholders must consent.

V.

A NUMBER OF RELEVANT FACTORS SHOULD BE CONSIDERED.

(a) *Possibly this is the most incremental and synergistic merger in history.*

There is no essential difference between this merger and other mergers generally. Other mergers may involve (or hopefully, involve) sharing facilities, gaining greater financial strength, decreasing overhead, obtaining a new line of products, or other considerations, *ad infinitum*. The hoped for results are frequently called synergism, which results for example when a unit valued at 100 is combined with a unit valued at 75 and the combination is envisaged as being worth 200. The 25 points extra are the synergism or hoped-for increment to be derived from the merger. Here, by reason of the merger, there is a theoretical increment in the proportion of the ratios of the above-stated example. The 25-point increment amounts to about half a billion dollars. This compares favorably with the total increment of any merger in history, and it is made possible only by DuPont's cooperation. Furthermore, it is not a virtue, as contended in the D-C Brief (page 23), but a vice of this transaction, that there is no disadvantage for DuPont in the transaction (assuming this is so) but actually an advantage in the pitiful privilege of obtaining an increase of 3 cents a share per book in earnings as compared with total earnings per share of $7.33.

Entirely apart from the $42.00 per share mark-up which Christiana shareholders would receive if they do not sell in such quantities as to depress the price for themselves (and everyone else) is the increased marketability of these shares especially for those holding the 90% of Christiana shares with over 5,000 shares (A. A512) and an average of 75,000 shares each (see page 7 *supra*). Most of these people are insiders with respect

to Christiana shares and so would be limited under SEC Rule 144, 17 CFR § 230, 144 to selling no more than 2,000 or so shares of Christiana every half year, and their potentiality in this respect when they receive DuPont shares, which will be similarly restricted, will be increased so that they can expect to be able to sell fifty to sixty thousand shares every six months (A. A429). This tremendous increase in marketability, which must be allotted to Christiana shareholders, is an increment of the merger itself worth the entire market price increment, giving Christiana shareholders a double dip. Tax freeness is a triple dip.

To state as a proposition that DuPont should be content because it suffers no harm was rightfully rejected by the Court, although the Court did state that it should be taken into account as a factor (Pet. App. 72a, f. 22). The Commission's opinion, of course, also considers that this is all DuPont shareholders are entitled to expect (Pet. App. 28a).

(b) *The right to share in tax savings of one party to a merger has recently been strongly supported.*

The right of DuPont's shareholders in a consensual transaction, which produces hundreds of millions of dollars of increment for Christiana shareholders to take into account that neither Christiana or its shareholders had any other means than a merger of achieving the results of converting Christiana shares into DuPont shares is strongly supported in a Case Comment in the December, 1976, issue of the *Harvard Law Review, Fairness Standard for SEC Approval of Mergers: Collins* v. *SEC*, Vol. 90, pp. 453-462. It singles out for special treatment the fact that "the court rejected Christiana's argument that those benefits were created by its own tax position and thus belonged to it" (p. 456). The Case Comment agrees with the Court's rejection on this and other general grounds and approves the Opinion. The Comment focuses on the benefit to Christiana and its shareholders of avoiding unfavorable tax consequences.

It follows the opinion of the court which picked up the testimony of Mr. Grimes, a DuPont witness (A. A446) in which he estimated that the taxes which might result to Christiana shareholders, were a one month liquidation under Sec. 333 of the Internal Revenue Code carried out, could be 200 to 400 million dollars depending on the definition of Christiana "earnings and profits," a specialized computation.

The report of Christiana's counsel forwarded to the financial advisors on July 8, 1972 (A. A877) enclosed a letter to Christiana's negotiators dated July 5, 1972 (A. A878) stating that a Section 333 liquidation "cannot be considered as a viable merger to the proposed merger. The letter also said "if all the legal questions discussed were resolved against Christiana the result would be an earnings and profits figure *vastly in excess* of 85.8 million." (Emphasis supplied.)

The Court's opinion, and the Harvard Law Review Comment which, of course, follows the opinion, may perhaps give undue emphasis to Mr. Grimes' figures. The *"vastly in excess"* estimate in Christiana counsel's letter certainly suggest a very great tax impact indeed, which may well include Mr. Grimes' figures, but this is all immaterial in any event because DuPont's liquidation under Section 333 was out of the question for the tax reasons stated. It had served its purpose as a method of getting the financial advisors to forget the market discount from net asset value (A. A849-50). See also Shapiro cross-examination on this aspect (A. A501-2).

There still remains a straight liquidation possibility under Delaware law which would not require duPont or DuPont shareholders' consent. This, of course, would involve Christiana shareholders in a capital gain situation. The 2.9 million shareholders who had a zero basis (Pet. App. 88a) would have a gain of $189 apiece, which at a 35% rate (including the preference tax for large shareholders) would be close to a half billion dollar taxes, with probably over a billion dollars in taxes to all shareholders. Needless to say, a liquidation would never be

approved by the shareholders. The conclusions of the Case Comment in the Harvard Law Review are even more persuasive in the light of this much higher tax consequence than the $400 million referred to in the article.*

(c) *Misuses of "value" in various contexts colors this case.*

The mesmerization which goes on by the segregation of the word "value" from the term, "net asset value" and by ornamentation of the segregated word "value" with decorative adjectives such as "intrinsic" or "fair", or most commonly "market", and which equalizes all the terms is unreasonable, especially when it is understood that net asset value really is only a technical term to describe the market price of a round lot of a traded stock security multiplied by the number of shares outstanding, the market price being only the function of the interaction of supply and demand with respect to a few round lot shares of traded stock at any particular time.

This matter was rather completely gone into at the cross-examination of Mr. Shapiro (A489-A496) to which the Respondent respectfully directs this court. The use of "net asset value" is a term of art, the use of market value in its stead is a misuse (if not a misrepresentation) when conclusions are suggested that can only be validated by depending on the difference between net asset value, and market value.

(d) *An important article on the valuation of freely-traded shares sheds light on this matter.*

In the D-C Petitioner's Brief in Appendix B-2 there is a reference to a pending suit for a refund of Federal income tax.

* In the *Watts* article, discussed next in this Section, the author stated the matter quite precisely (p. 63): "The process of determining value by use of actual sales prices may be precise in method, but the fact remains that sales figures precisely identify realizable amounts only for sales of limited amounts of securities at a particular moment in time, which time may not correspond at all with the access of the taxpayer to the market as a practical matter."

The Complaint in this suit was introduced as Murtaugh Exhibit 7 not printed), but relevant portions of it are found in printed Exhibit B to Murtaugh's "Request for Hearing and Advice" dated October 25, 1972 (A. A129, A144). The refund suit was predicated on an alleged error of the District Director of Internal Revenue in valuing distributions of 2¼%, 1⅔% and 2⅓% of the outstanding General Motors stock to Christiana in 1962, 1964 and 1965 at the market price of General Motors shares. The distributions were its share of the Du Pont divestiture. The firm of Dewey, Ballantine, Bushby, Palmer & Wood were counsel in the refund suit. (Murtaugh Exhibit 9, not printed.) That firm had also represented Christiana in the divestiture suit (177 F. Supp. 1).The principal attorney in the tax refund matter (disposed of by settlement about 18 months ago) was David E. Watts of the Dewey firm. He has written an exemplary article entitled, *"The Fair Market Value of Actively Traded Securities"* in the Fall, 1976, issue of *"The Tax Lawyer," (A. B. A.) Volume 30, at pages 51-84.* The very title challenges the contention that market price is an exclusive index of value as applied to the vast Christiana holdings of DuPont or even the four, five and six figure holdings of Christiana shareholders holding over 90% of Christiana's shares about to be converted into DuPont. Elsewhere, we will refer to this article as *Watts.* References pertinent to the issues in this case are found on pages 53, 54, 61, 62, 63, 65, 66, 68, 69, 72, 73, 74, 75 (including f. 42), 76, 77, 78, 79, 80, 81, 82, 83 and 84. It is no answer to dismiss the blockage cases as irrelevant here. Blockage implies a diminished price because of a volume of shares, whether or not there is a sale (*Watts,* 69). It allows for price depressing effects despite a prolonged and thoughtful period of marketing, including by secondaries (*Watts,* 74).

Since blockage is a mirror of market impact considerations, the cases on blockage bear on the matter of market impact in this case. When added selling of new DuPont shares equals the

amount for which a blockage allowance would be afforded to a large beneficiary of shares (even if there was no sale) this is an implicit recognition that amount of actual sales will have market impact equivalent to the blockage discount and, unfortunately, on all holders.*

The case of *Henry F. DuPont* v. *Commissioner* (1943), 2 Tax Court 246, involved a gift of 52,900 shares of DuPont, which was 4.8% of the then-outstanding DuPont shares. The Court considered, among other things, a table showing the total shares traded in 1938 (826,000). This was to demonstrate that the 52,900 shares relative to the market would depress all shares if sold. The government contended for quoted market price. The Tax Court concluded that the valuation of each share of stock should be $135.00—$18.00 or 13% below the market price. This is equivalent to a determination that that is what the market impact of these shares would be if sold (with some allowance for underwriting expense).

Blockage and Restrictions.

The Watts article (*supra,* at p. 79) deals with the subject of restrictions which the author states is an important factor in determining the fair market value of freely traded shares. The Commission's Opinion deals with this in an extended footnote (Pet. App. 21a f.43) and refers to Investment Company Act Release No. 5847 which deals with the impropriety of valuing restricted shares at market value "except for most unusual situations" which the Commission found this to be. Its reasoning in this last respect is not impressive as it is built upon a foundation restricting the valuation question to abuses in connection with

* The parameters of an author dealing with blockage do not go beyond a reasonable period after a single date so that for example he is not interested in when the ultimate effect of a big secondary will be absolutely dissipated so that there is no blockage effect. (See A. A892-893) The principles of blockage involving market depression are applicable where there are substantial secondary issues, and, as has been argued, by repetitive issues with cumulative effects.

investment letter stock. This narrow reading of the restriction price reduction concept is rebutted by the considerable authorities cited in Watts, *supra,* p. 82 under the subheading "Valuations reflecting restrictions" and at p. 84, "Valuations reflecting both blockage and restrictions" which refer to only a few investment letter situations and these without differentiation. The last paragraph of the Commission's footnote 43 (appearing at Pet. App. 22a and 23a) wherein the opinion refers to the fact that "(. . . most) of the DuPont stock to be received by Christiana stockholders will itself be restricted under the Securities Act so that it would be impermissible to take the restriction on Christiana's DuPont stock into account." As the Watts Article citation authorities show Christiana's DuPont shares restrictions would cause its new DuPont shares to be valued at or around Christiana's prior market value, and granted, for the sake of argument, that Christiana's shareholders are indirect owners of Christiana's DuPont shares, they are owners, *cum onere,* of such shares with the value reduction incidental to the restriction. Furthermore, obviously the same persons who are restricted post-merger with respect to DuPont shares were similarly restricted with respect to their Christiana shares and were limited by Rule 144—17 Ch. 11 CFR § 230, 144—from selling in a half year more than an average weekly number of shares sold in the preceding 4 weeks. With the limited market for Christiana shares, large shareholders could have sold a truly significant amount of Christiana shares over a 6 month period—something between 1,000 and 3,000 shares, but with the same restriction, as holders of DuPont post-merger, these shareholders could sell 50,000 to 60,000 shares in a 6 month period (A. A429).

In the Christiana refund suit Murtaugh Exhibit 7, not printed, it is claimed that in addition to the blockage discount called into play by the fact that Christiana received 2⅓%, 11⅔% and 2⅓% of General Motors in 1962, 1964 and 1965 respectively, calling for a 8% to 14% discount the claim is also made that in addition to the blockage discount Christiana was entitled to an

added discount because of restrictions imposed by the final divestiture decree. In the printed appendix as Exhibit B to this Respondent's Request for Hearing and Advice at (A. A144-7) it recites its claim as to the blockage factor "without taking into account the impairment in value resulting from the restrictions placed on such stock by the judgment." The additional paragraphs in the Complaint which specifically claimed an additional discount because of the restrictions was not included by this Respondent in his Request but enough is there to show that other paragraphs, which can be found in unprinted Murtaugh Exhibit 7, did make a claim for a price reduction based not only on blockage but on the restriction.

(e) *The Commission's evaluation of dispersion as valueless is on solid ground.*

The Commission's finding of no benefit from an effective dispersion of Christiana's DuPont shares (Pet. App. 19a) is more realistic than the Court's. The Commission's Opinion, in an area in which it certainly has sophistication and expertise, rejected the argument that DuPont would be better off were DuPont's managers freed from effective stockholder supervision, which Christiana, if the occasion required, could easily supply, and would supply in its own interest and the interest of all DuPont shareholders (Pet. App. 19a). This is consistent with the Commission's published views in its report *"Public Policy Implications of Investment Company Growth,"* H. R. 2337, 89th Congress, Second Session, 310-11 (1966). In a chapter of this report are comments on the "significant" benefit scattered shareholders may derive from the monitoring that investment companies, in their own interests, impose on management (a benefit to be lost here). Moreover, the notion that scattered shareholders can effectively protect their own interests as against the interests of management is vestigial. For effective protection, some sort of extra-managerial, concentrated leadership is frequently needed. (See Paragraph 22 of Murtaugh's Supplemental Petition for Rehearing (A. A220) and the Exhibit attached at (A. A224-6). The Eighth Circuit Opinion, when it states that it disagrees with the Commission and believes effectively widespread dispersion would benefit DuPont and the public is not in accord with current estimation, as the Commission stated (Pet. App. 19a). The D-C Petition departing from its theme of Commission expertise applauds the Court's Opinion in this respect. Of course, the Court does agree with the Commission that effective dispersion would not be accomplished in view of the concentration of DuPont family members as the large holders of Christiana, who, by hypothesis, would not be sellers of newly-acquired shares (Pet. App. 85a). The Commission is much more capable of making an accurate characterization, and protecting the judgmental processes from being misled by unreal concepts of the potency of corporate democracy. See *"Fair Shares in Corporate Mergers and Takeovers," Brudney & Chirelstein (Dec. 1974) 88 Harvard Law Review,* subhead *"Ratification"* at pp. 299, *et seq.*, where SEC and other authorities are gathered as to the inadequacy of a stockholders approval requirement as a protective measure, even if there is full disclosure. Where, as here, we are dealing in a specially regulated sphere which prohibits transactions such as this and has specific mandates before exemptions are granted of taking into account the consideration paid and received and reasonableness and fairness and no overreaching, to thrust DuPont shareholders back into the corporate jungle the 1940 Act was intended to protect them from, and to dispense with any factoring in of a result that arm's-length bargaining would entail, is uncalled for. The SEC Petition concedes that an arm's-length bargaining result would have been a factor in an unregulated merger (SEC Petition, p. 31) if DuPont were similarly controlled by a company not within the statutory classification of an investment company.

(f) *This is not a liquidation nor an exchange of equivalents.*

The SEC brief utilizes, incessantly, the power of suggestion in an effort to turn the proposed merger into a liquidation. Its

first effort in this direction is found on page 7 where it is stated that "because of its tax disadvantages and the discount at which its shares sold, it was desirable that its stockholders become direct, instead of indirect, owners of DuPont stock."* The SEC brief at page 7 then states with a high degree of suggestion and substitution: "It therefore proposed *liquidation* of Christiana by means of a merger into DuPont." (Emphasis supplied.) A close reading of the letter of Christiana's President, DuPont (Pet. App. 47a, f. 5)* shows no suggestion of liquidation. The attempt to condition the consideration of this cause by referring to it as a liquidation is the outstanding characteristic of the SEC brief. The term is used on pages 7 (2), 10, 14, 15 (4), 16, 22, 23 (3), 24, 25, (2), 27, 28 (2) and 32. This is not a liquidation. It is a merger. A liquidation could be accomplished without DuPont's consent. The Commission's opinion in no way suggest this is a liquidation although stating: "The Christiana stockholders *could have* caused Christiana to be liquidated. They would then have become the direct owners of the DuPont shares now held by Christiana. Had they done so, the situation would have been essentially the same as that contemplated by this merger." (Pet. App. 23a-24a) Emphasis supplied.) The Commission went on to state that "a liquidation, *unlike* this merger, would have adverse tax consequences for Christiana stockholders," (Pet. App. 24a) (Emphasis supplied.)

The proposed merger is thus designed to *avoid* a liquidation because of the serious tax problems that a liquidation would engender for its stockholders. Nowhere in the opinion is it suggested that this is a liquidation by merger, or that it is a liquidation in any sense of the word.

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* The SEC brief omits an additional disadvantage catalogued in the same sentence of the President of Christiana's letter suggesting a merger, which was "there are certain conditions that limit to some extent the marketability of Christiana common stock" (Pet. App. 48a, f. 5).

* Also a vice-president and director of DuPont, and a member of its executive committee.

At page 10, the SEC Brief states that the Commission viewed the proposed transaction as the "exchange of equivalents, referring to a sentence found at Pet. App. 9. The D-C petition on page 7 makes the same assertion based on the same reference. Both briefs lift the words "exchange of equivalents" out of context. The Commission's use of the term is in an early Section (VI) devoted to setting forth the essence of the D-C view of the matter before it, with which its Division of Investment Management Regulation agreed. This is obvious from the last of the three paragraphs of Section VI (Pet. App. 10a). There is nothing in Section VI of the opinion that is a finding or statement of the Commission's view. This is more obvious since the Section starts off with the statement "At first blush . . ." The style of the author of this Opinion lends itself to elliptical misquotation. If he had started Section VI as he closed it "(That) in essence is the view of the two companies involved" this correction of a distortion of the opinion would not be necessary. The antecedent of "That" in the third paragraph is obviously all the material referred to in the first two paragraphs. To make the matter clearer, the next section of the Opinion (VII) (Pet. App. 10a) sets up the contentions of the Objectors.

(g) *Harmless error, if any, was involved in Dean Upson's appointment.*

Assuming that this Court feels that there was error in appointing Dean Upson, it must be because of a disagreement with the Commission decision that, as a matter of law, net asset value considerations are so controlling as to eliminate all other considerations. Our opponents apparently contend that this is what the Eighth Circuit Court should have done. However, they never made a motion either at the time of the oral argument or thereafter, when they advised the Court it couldn't appoint a special master, nor after they received word of Dean Upson's appointment as a contract consultant, nor even, after the filing of the

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* The dissenting Judge apparently consented to the appointment and cast no aspersions in his dissenting opinion.

Report nor after the Opinion of the Court. This was open to them under the plain terms of Section 43 of the 1940 Act, and if their Motion was denied, the error, if any, in the appointment would have been preserved for review here. The petitioners elected to appeal rather than to seek a ruling from the Commission based on evidence. So far as Christiana is concerned, it really had nothing to lose because any setback is not irretrievable and the status quo is what they have lived with for 60 years. The risk-reward factor was in the petitioners' favor, virtually no risk, and merely reward deferred. The half-billion dollar tax-free windfall with the transfer of Christiana's control to management and with the luggage of an obsequious registration agreement was obviously preferable to a return to the agency with a direction to consider the matter covered by the Upson report, assuming net asset value was not absolutely controlling. As the Commission said of its original Opinion in the Order Denying Rehearing, "That holding does not turn on evidentiary details. It rests on our reading of the Act. Hence, additional evidence cannot alter the result." (Pet. App. 42a.) Moreover, it is clear that if net asset value is not controlling there is no use remanding this executed merger agreement for further consideration, because for no other reason could the "striking disparity" be justified. This is not a case in which the Commission has alternatives such as in a rate case or a reorganization case. The parties have made their choices, executed an agreement and the only question is, can *this* particular agreement to merge be deemed to qualify for an exemption under Section 17(b), of the 1940 Act?

(h) *Harriman* v. *DuPont discussion.*

There is a two-page discussion of the *Harriman* v. *DuPont* case (D. Del., 1975) 411 F. Supp. 133, in Appendix A6 and 7 to this Respondent's Brief in Opposition to Petitions of Writs of Certiorari. Each Court insisted its rulings were on different issues. The opinion below refers to it in footnote 18 (Pet. App. 66a) and footnote 23 (Pet. App. 72a). In the earlier footnote

the court below indicated its recognition that it did not have a rule 10(b)(5) issue before it, as the Harriman case did; in the latter footnote the Court refused to decide whether Delaware law was properly applied but said "we simply hold that the federal test of reasonableness and fairness has not been met here." In the opinion in the *Harriman* case in the last paragraph of footnote 38 (411 F. Supp. at 151) the Court noted the fact that the issues before that Court and the Eighth Circuit were separate and distinct. See also footnote 132 at 411 F. Supp. at page 159 where the Court in the *Harriman* case stated that the correctness of the issuance of the exemption was not before the Court but the question was presently before the Circuit Court of Appeals in the Eighth Circuit.

VI.

THIS CAUSE SHOULD NOT BE REMANDED UNLESS LACK OF PROOF OF MARKET IMPACT IS CRITICAL TO ITS DISPOSITION.

In *Ernst & Ernst* v. *Hochfelder* (1976), 96 S. Ct. 1375, 1391, this Court refused to remand for a trial under a standard other than negligence since the Plaintiff had specifically disclaimed fraud or intentional misconduct as a basis for liability. So, too, in this case, inasmuch as the Commission's Opinion relies upon the construction of the statute as legally requiring net asset value to control in a merger of an investment company and a controlled affiliate, if that is not the law, then there are no redeeming features, as the Commission has pointed out, to offset the fact that the transaction is in no other way sustainable, and so a remand, too, would be inappropriate.

The "striking disparity" of benefit which the Commission found indicates not a remand to the Commission but to the drawing boards of the companies to construct a less vulnerable deal. Contrary to the usual fate of the losing side in extended litigation, the happy ending is that no harm has been done, merely the *status quo* preserved.

If market impact is a factor to be given some value, this merely reinforces the futility of remandment for any addition to the disparity would obviously break the camel's back if not broken already by the "striking disparity" (Pet. App. 35a) of benefits. If market impact would be a factor, if more evidence was in the record, then this Court should remand for the Petitioner did everything possible to be ready, protested a program of consecutive hearings beginning February 5, 1973 unless his motion for a continuance at the end of the hearing was left pending, and, in the alternative, requested a continuance of the hearing (A. A227) and received the ruling of the Administrative Law Judge that his participation in the hearing would not be a waiver of his standing request for a continuance at the end of the hearing (A. A227). This Respondent's motion for a continuance was discussed at the conclusion of the testimony and some outline of further material this Respondent wished to introduce as evidence was mentioned, as well as his motion for continuance, pending since the start of the litigation (A. A612). The Judge took up the request for continuance and denied it (A. A614-615), just before the end of the session. When the Opinion of the Commission was rendered, this Respondent filed within allowed time his Supplemental Petition for Rehearing, including a Motion for Leave to Adduce Additional Evidence (A. A204-223). This was denied in the Memorandum Opinion and Order Denying Rehearing and Leave to Adduce Additional Evidence, which was the subject of a separate Petition to Review to the Circuit Court of Appeals and which is before this Court, along with this Respondent's Petition to Review the original order.

If the matter is so hairline that only greater and more specific proof of the probability of market impact can justify the finding that the 2½% discount will not stand up under the standards of Section 17(b)(1), then it is submitted that the proper course is to remand to the Eighth Circuit with whatever instruction this Court chooses to give on this subject for the purpose of remanding to the Commission to take further evidence.

It is respectfully submitted, however, that the proof of actual market impact probability would be merely cumulative, even though the Commission viewed it as the crux of the case (Pet. App. 25a) though ultimately finding it not cognizable or relevant.

VII.

THIS MERGER CANNOT BE SUSTAINED ON EVIDENTIARY GROUNDS BUT A REJECTION OF IT CAN BE.

The D-C petition at page 26 attempts to show that the evidence before the Commission established the earmarks of an arm's-length bargain. This is an attempt to sustain an agency decision on a basis that was not relied on by the agency. There are many cases in this court, and elsewhere, that hold that this cannot be done. *Investment Company Institute* v. *Camp* (1971), 401 U. S. 617, 627-8. As the Supreme Court said recently in *Federal Power Commission* v. *Texaco Inc.* (1974), 417 U. S. 380, 397:

> Had the order unambiguously provided what the Commission now asserts it was intended to provide, we would have a far different case to decide. But as it is, we cannot 'accept appellate counsel's *post hoc* rationalizations for agency action'; for an agency's order must be upheld, if at all, "on the same basis articulated in the order by the agency itself." *Burlington Truck Lines,* 371 U.S. at 168-169; *SEC* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947).

Presumably the learned counsel are quite aware of this but are attempting to persuade the Court that it should overlook the principles set forth in the cases just cited and sustain the decision of the Commission on grounds which the Commission did not adopt. It certainly could have improved the legal position of the Petitioners had the Commission accepted the facts set forth in the D-C Petition (page 26, footnote 18). A fair inference is that the Commission did not believe the facts in the record would warrent an exemption on the basis of evidence but that the "incommensurate," "striking disparities" in benefits

could only be justified by the legal ruling it made. This being the case, as this Respondent strongly argues, there is no Occasion for a remand. The Opinion of the Court below (Pet. App. 77a, Footnote 29) noted that "The Commission skirted the objectivity issue by holding that as the issues presented were essentially legal in nature, they could not be resolved by reference to the opinion of financial experts." The Commission staff had harsh words to say about the lack of independence of the financial advisors as is set forth in the Court's Opinion (at Pet. App. 76a, Footnote 28) which the Court stated was, in its judgment, supported by the record as a whole.

This brings up an intriguing consideration in connection with fairness under the 1940 Act. If a merger ratio purports to be based upon an independent examination by financial analysts who were being advised that there was a limit imposed upon the ratio by an alternative, which in fact never existed and was never believed in by DuPont's negotiators, and if this was intention involving *scienter* would a merger be vulnerable if the ratio might otherwise within the range of fairness and, of course, was approved by the shareholders who are only tools in the hands of a management anxious to seize power and in the hands of a controlling shareholder anxious to reap half a billion dollars tax-free for its shareholders and some increase in income and an enormous increase in marketability. Is a transaction rendered unfair if purportedly independent financial advisors are directed to be governed by false considerations? In the case of *Harriman* v. *DuPont* (D. Del. 1975, 411 F. Supp. 133), cited throughout the D-C Brief, the judge found that (p. 144)

> "The range of merger terms initially recommended by Morgan Stanley and Kidder Peabody was *heavily influenced* by the theoretical availability of a 'one-month: liquidation under Section 333 of the Internal Revenue Code, 26 U. S. C. § 333, as a supposedly viable alternative to the proposed merger for Christiana in which Christiana's shareholders could realize a return approximating a small discount from net asset value and thereby similarly eliminate

> much of the market value disparity attaching to Christiana common." (Emphasis supplied.)

The Court further found since the categorical assertion of a limited ratio was believed by DuPont to be "merely a tactical ploy" (p. 145) thus the fact that the financial advisors were loaded down by this consideration and further instructed by DuPont's counsel (A. A850) that they should proceed *"on the assumption that the 30-day liquidation provisions would operate to Christiana's benefit here, DuPont would be justified in giving little weight to the market value of Christiana in the merger negotiations,"* raised an issue as to adequacy of disclosure, if not fully disclosed in the upcoming proxy material.

This brings up the interesting question of whether the *scienter* of a misrepresentation to and consequent manipulation of the financial advisors rendered the merger ratio determination unfair. In the *Harriman* case the Judge refused to enter a final order, so no appeal has been possible, but instead rendered an interim decision pending a review of the future proxy statement (see page 166, footnote 165).

This portion of Respondent's Brief may go too far afield to be helpful to this Court's decision of the case, but at least may alert it to the necessary discriminating treatment that will not eliminate misrepresentation and deception as an element in deciding the issue of fairness under the 1940 Act, unless this Court decides to so rule.

VIII.

THE MERGER TERMS ARE PATENTLY NOT BALANCED AT ALL AND ARE UNFAIR ON THEIR FACE.

The above caption is responsive to the Commission's statement that the Act in Section 17(b)(1) does not require that "the benefits to the parties must be nicely balanced." (Pet. App. 20a).

Using pre-merger talk figures, this is what the Opinion and Order sanctions:

Christiana Shareholder Gets	Dupont Shareholder Gets
$41.25 in added *available* price of investment (close to half billion dollars)	$1.10 increase in equity per share (80 cents net) (Not an *available* sum to shareholders.)
7.2% increase in dividends.	3 cents increase in share of earnings. $7.34 vs. $7.31 per 1971 figures (Also not available)
Liquidity (Opportunity to cash in marketable shares.)	No increase in market value
¾ restricted allowed vastly expanded (30 times) liquidity privilege in auction market under Rule 144.	Loses:
Registration rights. (Not available to unaffiliated shareholders.)	Effect of Market Impact of added shares. Affects DuPont as a company as to shares issued in acquisition or in new financing, and also all stockholders who sell.
¼ free of restrictions for unaffiliated shareholders.	Surrendered responsibility of directors to be guided by DuPont's interests from time to time in regard to Registration.
Tax free liquidation result. (a billion avoided)	Management responsibility to shareholders interest underwritten by Christiana's centralized shareholder interest in DuPont's operation and possibility of DuPont shareholders being effectively protected from poor management.
Operating cost gone .3%	
Relinquishes:	
(Transfers)	
Voting Control	
DuPont Management Gets	
Control*	

* Except it surrenders control of registration.

CONCLUSION.

The decision of the Circuit Court of Appeals should be confirmed.

Respectfully submitted,

LEWIS C. MURTAUGH,
TIMOTHY J. MURTAUGH III,
MURTAUGH, NELSON & SWEET,
105 West Adams Street,
Chicago, Illinois 60603,
Attorneys for Lewis C. Murtaugh, Trustee for Emmanuel and Helen Steib, Under Declaration of Trust dated 8/30/56.

APPENDIX A.

In addition to the provisions of the Investment Company Act of 1940, 15 USCA 80a-17, which were set forth in Appendix A of the Brief of the Petitioners, DuPont and Christiana, the following sections of the Act are pertinent:

15 USC §§ 80a-1(a)(3)

> (a) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to section 79z—4 of this title, and facts otherwise disclosed and ascertained, it is found that investment companies are affected with a national public interest in that, among other things—
>
> (3) such companies customarily invest and trade in securities isued by, and may dominate and control or otherwise affect the policies and management of, companies engaged in business in interstate commerce.

* * * * *

15 USC §§ 80a-17(d)

> (d) It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company (other than a company of the character described in section 80a—12(d) (3) (A) and (B) of this title), or any affiliated person of such a person or principal underwriter, acting as principal to effect any transaction in which such registered company, or a company controlled by such registered company, is a joint or a joint and several participant with such person, principal underwriter, or affiliated person, in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant. Nothing contained in this subsection shall be deemed to preclude any affiliated person from acting as manager of any underwriting syndicate or other group in which such registered or controlled company is a participant and receiving compensation therefor.

APPENDIX B.

Excerpt from DuPont Brief in *United States* v. *DuPont et al.* (1961), 366 U. S. 316, the last part of Murtaugh Exhibit 2 in the record of this case (not printed):

Under the plan, the trustee would have been required to sell each year, for ten years, approximately 2,000,000 shares of General Motors stock—the duPont shares allocable to Christiana, Delaware and the stockholders of Delaware, plus one-tenth of the General Motors stock owned by Christiana itself.[45] In addition, there would have been substantial selling by du Pont stockholders of the shares of General Motors that they received in the annual distributions to realize cash with which to pay the income taxes due. The depressing market effect of both of these types of sales would in turn have led to additional sales by those holders of the remaining 218,000,000 General Motors shares who would have been disinclined to retain a stock that was to be depressed in price well below its true market value for a decade. Again, the finding of the court below after an extensive review of the evidence that was adduced on these matters

45. Under the provisions of appellant's proposed judgment the trustee would have received 63,000,000 shares of General Motors stock from du Pont and 535,500 shares from Christiana. He would have distributed over a ten-year period 47,865,385 shares to du Pont stockholders other than Christiana, Delaware and the stockholders of Delaware. He would have sold over the same period for the account of these latter corporations 19,018,997 shares, and for the account of the stockholders of Delaware 651,188 shares, or a total of 19,670,115 shares. See du Pont Exh. 51, R. 3057; Chr. Exh. 4, p. 3, R. 3076.

Murtaugh's Supplement to Above Footnote.

The government's plan as detailed in Justice Frankfurter's dissenting opinion at page 342, had this additional facet: "If, in the trustee's judgment, 'reasonable market conditions' did not prevail during any given year, he was to be allowed to petition the Court for an extension of time within the ten year period."

(R. 3212-3234) was that the combined selling would have had a very serious depressing effect (R. 3247).

Even one of the annual sales by the trustee, approximating more than $80,000,000 (assuming a price for General Motors of something above $40 per share), would have been a major financial undertaking. Since 1936, there have been only ten rights offerings of industrial common stocks in excess of $80,000,000, and only four non-rights offerings of such stock in excess of $75,000,000. du Pont Exhs. 30, 32, R. 3035, 3038A.[46] An offering of $80,000,000 each year for ten years would have been a project unique in financial history. Lenz, R. 2066. See also Emerson, R. 1485, 1524-1525. Since an ample supply of General Motors stock is and has been freely available to investors who wish to buy it at the prevailing market price (R. 1518, 2108), the demand necessary to absorb each annual offering would have had to be created. That could have been done only by a decrease in the price below what it would have been had the 2,000,000 shares not been added to the supply side of the supply-demand equation. The repetition of such offerings annually for ten years, moreover, would have produced a market impact considerably larger than the impact of any single offering. On this the witnesses who had had wide experience in the marketing of securities were emphatic (Emerson, R. 1508; Lenz, R. 2066-2067; Forgan, R. 2237-2238). Appellant's witnesses were inclined to agree (Friend, R. 1030, 1036; Boulton, R. 537-538). Moreover, the continuous pressure on the price of the stock would have led sophisticated purchasers to defer purchases until it reached a very low level. The fact that substantial amounts of General Motors stock would have been distributed to many institutional investors as dividends on their du Pont stock would also have tended to decrease the demand by such investors for General Motors stock. Herd, R. 1838-1839.

46. Two of these four non-rights offerings in excess of $75,000,000 are reflected in exhibits not printed. du Pont Exh. 63; App. Exh. 679.